SUPREME COURT, U.S.

RECORD APPENDIX

FILED
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Supreme Court of the United States

October Term, 1967

No. 127

READING COMPANY, *Petitioner*

v.

FRANCIS SHUNK BROWN, 3RD, etc., et al.

THOMAS RAEBURN WHITE, JR.
MICHAEL H. MALIN
H. MERLE MULLOY
THEODORE W. FLOWERS
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1900 Land Title Bldg.
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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED MAY 4, 1967
CERTIORARI GRANTED OCTOBER 16, 1967

Supreme Court of the United States

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DOCKET ENTRIES

UNITED STATES DISTRICT COURT

1962		
Nov.	16	Debtor's Petition for Arrangement under Chapter XI, List of Creditors, Statement of Assets and Liabilities, and Affidavit for and Order extending time for filing Schedules, etc., filed.
	16	Referred to Thomas J. Curtin, Referee.
	16	Petition and Order appointing Francis Shunk Brown, III, as Receiver, with leave to operate the business, filed. (Bond $5,000)
	19	Bond of receiver in $5,000 with Fidelity & Deposit Co. of Maryland as surety, approved and filed.
	20	Petition and Order authorizing receiver to employ Samuel Marx, Esq., as counsel, filed.
	21	Affidavit of mailing notices, filed.
	21	Order confirming appointment of receiver, etc., filed.
Dec.	6	Schedules and Statement of Affairs, filed.
	12	Petition of receiver for appointment of appraiser, filed.
1964		
Oct.	9	Referee's certificate for review, filed.
1965		
Feb.	26	Argued sur Referee's certificate for review.
June	4	Trustee's brief, filed.
	4	Brief of Reading Co., filed.

	4	Memorandum of law of U.S., filed.
	4	Reply brief of Reading Co., filed.
	9	Memorandum, Van Dusen, J. and Order that the petition of Reading Co. for review, certified by referee's certificate for review is DENIED, and AFFIRMING order of 9-30-64 of referee, filed. 6-10-65 entered and notice mailed.
July	1	Notice of Appeal by Reading Company, Claimant, from Judge Van Dusen's Order of 6/9/65, filed. (Copies mailed to Arthur E. Newbold, III, Samuel Marx, and Drew J. T. O'Keefe)
	1	Copy of notice to Clerk, U.S. Court of Appeals, filed.
	1	Bond of Reading Company for costs on appeal in the sum of $250.00 (cash), filed.
	20	Record transmitted to U.S. Court of Appeals.

1965 COURT OF APPEALS

Aug.	13	Stipulation extending time for furnishing Statement of contents of Appendix to August 30, 1965; and for filing and serving brief and appendix for appellant to October 4, 1965, filed. Approved.
Sept.	27	Stipulation extending time for filing and serving appellant's brief and appendix to November 4, 1965, filed. Approved.
Nov.	2	Stipulation extending time for filing and serving appellant's brief and appendix to January 4, 1966, filed. Approved.
1966		
Jan.	3	Brief and appendix for appellant, filed.
Feb.	4	Stipulation extending time for filing and serving appellee's (Francis Shunk Brown, III) brief and appendix to March 7, 1966, filed. Approved.

	11	Stipulation extending time (out of time) for filing and serving appellee's (United States) brief to March 7, 1966, filed. Approved.
Mar.	4	Motion to extend time for filing and serving printed brief for appellee—United States to Mar. 22, 1966 (with typewritten copies to be served by Mar. 14, 1966), filed. Certificate of service attached. Granted.
1967		
Jan.	6	Opinion on rehearing (Staley, Chief Judge and McLaughlin, *Kalodner*, Hastie, Smith, Freedman and Seitz, Circuit Judges, with *Freedman*, Circuit Judge, dissenting and *Smith* and *Seitz*, Circuit Judges concurring in the dissent), filed.
	6	Judgment affirming the judgment of the District Court, filed June 9, 1965, filed.
	20	Petition for rehearing by appellant, filed.
Feb.	13	Order (Staley, Chief Judge, and McLaughlin, *Kalodner*, Hastie, Smith, Freedman and Seitz, Circuit Judges) denying appellant's petition for rehearing, filed.
Apr.	10	Certified judgment in lieu of formal mandate issued.

PROOF OF CLAIM

IN THE DISTRICT COURT OF THE UNITED STATES

FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Chapter XI No. 27540, In Bankruptcy

In the Matter of

I. J. KNIGHT REALTY CORPORATION

Debtor-Bankrupt

STATE OF PENNSYLVANIA }
COUNTY OF PHILADELPHIA } *ss.*

B. Howarth, of Philadelphia, in the County of Philadelphia, State of Pennsylvania, being duly sworn, deposes and says:

(C) That he is the Secretary of READING COMPANY, a corporation organized and existing under the Laws of the State of Pennsylvania, and carrying on business at 12th and Market Streets, Philadelphia County of Philadelphia, State of Pennsylvania, and is duly authorized to make this proof of claim on its behalf;

1. That I. J. Knight Realty Corporation, the above-named bankrupt (debtor), was at and before the filing by (or against) it of the petition for adjudication of bankruptcy, and still is, justly and truly indebted (or liable) to said corporation in the sum of Five hundred fifty-nine thousand seven hundred thirty and 83/100 dollars,

2. That the consideration of said debt (or liability) is as follows:
Damage to claimant as set forth in Statement of Claim attached hereto.

3. That no part of said debt (or liability) has been paid,

4. That there are no set-offs or counter-claims to said debt (or liability).

5. That said claimant does not hold, and has not, nor has any person by its order, or to deponent's knowledge or belief, for its use, had or received, any security or securities for said debt (or liability).

6. Claim is for administrative expenses due to negligence of the Receiver in operation of business of the debtor. See Statement attached.

7. That your deponent hereby authorizes W. Wilson White and/or Michael H. Malin to attend any and all meetings of creditors of the bankrupt (or debtor) aforesaid, for and in the name of the undersigned, to vote for or against any proposal or resolution that may then be submitted under the Acts of Congress relating to bankruptcy; and in the choice of trustee or trustees of the estate of said bankrupt (or debtor); and for the undersigned to assent to such appointment of trustees; also to accept any composition proposed by said bankrupt (or debtor) in satisfaction of his debts, and to receive payment of dividends, and of money due the undersigned under any composition; and for any other purpose in the undersigned's interest whatsoever, with full power of substitution.

READING COMPANY

By B. HOWARTH,
Secretary

Subscribed and sworn to before me this 1st day of April, 1963.

ARTHUR H. WILLIAMS

Notary Public, Philadelphia, Philadelphia Co.

My Commission Expires January 17, 1965

[Seal]

STATEMENT OF CLAIM FOR DAMAGES CAUSED BY NEGLIGENCE OF RECEIVER

1. Claimant is Reading Company, a Pennsylvania corporation and a common carrier, with its main terminal and principal place of business at the Reading Terminal Building, 12th and Market Streets, Philadelphia, Pennsylvania.

2. Claimant, Reading Company, was, on January 1, 1963, the owner of real and personal property in the vicinity of 10th and Diamond Streets, Philadelphia, Pennsylvania, which property consisted of a railroad signal tower and railroad right of way with rails, ties, switches and related equipment, by means of which the Reading Company transported persons and property to and from the Reading Terminal to various points in and out of Philadelphia, and which property was destroyed and damaged by fire on January 1, 1963, forcing Reading Company to curtail these operations from 5:15 p.m. on January 1, to 6:00 p.m. on January 7, 1963. The damage to the claimant resulted from the acts and omissions hereinafter set forth.

3. The defendant in this claim is Francis Shunk Brown, III, Receiver of the debtor corporation, who was appointed such Receiver and given leave to operate the business of the debtor corporation by order of this Court entered November 16, 1962; and who in such capacity was in exclusive custody and control of the Fretz Building, a rental property located at 10th and Diamond Streets, in the City of Philadelphia, which was the principal asset of the debtor corporation.

4. By virtue of the terms of §959(b) of the Judicial Code (28 U.S.C. §959(b)), said Receiver was required to manage and operate the property in his possession as Receiver according to the requirements of the valid laws of Pennsylvania, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

5. On January 1, 1963, a twelve-alarm fire, characterized as the biggest in the history of Philadelphia, occurred in the Fretz Building. The first started because of, and was caused by, the negligence of the Receiver and the negligence of the Receiver's agents, servants and employees. The fire was caused and permitted to spread far beyond its normal confines by and through the negligence of the Receiver and his agents, servants and employees. The fire destroyed and damaged all the property of persons who were tenants of the building. It spread to such an extent beyond its normal confines as to destroy and damage real and personal property adjoining and in the immediate neighborhood, including buildings and their contents, railroad tracks, equipment and appurtenances, and railroad cars and vehicles in the vicinity, together with their contents. It required the City of Philadelphia to engage in emergency demolition of damaged properties for the protection of the public. The circumstances leading to the starting of this fire and to its spreading beyond control are hereinafter set forth in detail.

6. On December 31, 1962 and January 1, 1963, the Philadelphia area was subjected to weather conditions which caused high winds and sub-freezing temperatures, with the temperature at times being only a few degrees above zero degrees Fahrenheit. These conditions, however, were not extraordinary.

7. The Receiver did not take adequate measures to repair drafty doors and windows in the Fretz Building so that it would not be so cold as to cause the freezing of the sprinkler system in the building and its being rendered inoperative.

8. The Receiver did not instruct nor require George Benezet, his servant, agent and employee, employed by him as Chief Engineer of the Fretz Building, to keep the heat in the building sufficiently high on the days December 29, 30, and 31, 1962, so that the sprinkler system of the building would not freeze solid and be rendered inoperative.

9. On December 31, 1962 and January 1, 1963, the sprinkler system of the Fretz Building was frozen solid because of the cold in the building and was therefore rendered inoperative. The cold was due both to failure to heat the building to the greatest extent possible and to the drafty condition of the windows and doors of the building. This sprinkler system, like all sprinkler systems, was designed to emit water at the time of the occurrence of a localized fire in the building and thereby quench it and prevent its spread. The debtor corporation and its Receiver were required by ordinance and regulation of the City of Philadelphia, particularly §5-1403 of the Fire Code, as well as by ordinary prudence, to have said sprinkler system maintained in operative condition at all times.

10. George Benezet, the said Chief Engineer of the Fretz Building, on December 31, 1962, turned off the sprinkler system for repairs to frozen and burst pipes, and left it off on January 1, 1963, in an unrepaired and inoperative condition.

11. The Receiver did not take any required measures to insure that the sprinkler system of the Fretz Building would be restored promptly to working condition.

12. Neither George Benezet nor any other agent, servant or employee of the Receiver nor the Receiver himself, notified the Philadelphia City Fire Department that the sprinkler system was turned off, which notice is required by §5-1403 of the Philadelphia Fire Code.

13. The fire which began in the Fretz Building would not have spread and would not have caused the widespread damage that it did cause had the sprinkler system of the building been operative.

14. The Receiver did not post a fire watch in the Fretz Building on December 31, 1962 and January 1, 1963, even though it was then without sprinkler protection, and even though the Receiver knew, or should have known, that the

Fretz Building was entirely wooden in its interior, that there were two fuel oil service businesses near the Fretz Building storing large quantities of flammable oil, and that the Fretz Building was entirely surrounded by dwellings which were much smaller than it and which would be subjected not only to a shower of sparks and burning material from a burning building of such relative height but to total destruction from falling walls, and that the tracks of a railroad heavily travelled by citizens of Philadelphia was alongside the building and would be subjected to damage and resultant injury to the public if a fire in the Fretz Building should start and be permitted to spread.

15. During the evening of December 31, 1962, the said George Benezet, the Receiver's agent, servant and employee, was working to turn off all of the water valves which fed the defunct sprinkler system in the Fretz Building. At or about 8:00 p.m. on December 31, 1962, George Benezet, along with one John Abel, went up to an area of the Fretz Building which was known as the "C" Building, or water tower area, on the eighth floor of the building, and there, for the purpose of providing heat and light while working on the water valves, George Benezet made a dangerous electrical connection of a test socket to a high voltage, high amperage elevator control switchbox located in the area, by connecting one lead of the test socket to a knife switch and the other to the handle of the switchbox, thereby by-passing the safety fusing and setting up an electrical circuit which would continue to generate an uncontrolled heat and current flow until it caused arcing in gaps and flames in all lines, including a line to an electric heater which Benezet and Abel left operative and connected to the aforesaid dangerous connection when they departed from the eighth floor of the Fretz Building at or about 11:00 p.m. on December 31, 1962.

16. The circuit as hooked up by George Benezet was dangerous and was known by him to be dangerous. It caused intense heat in the electrical lines running from the base-

ment of the building to the eighth floor, and the heat grew in intensity from 11:00 p.m. on December 31, 1962 until it caused the fire on January 1, 1963, at or about 5:00 p.m.

17. The circuit as hooked up by George Benezet caused intense heat in the switchbox and in the cords running along the floor to the electric heater, generating heat until it burned through its insulation and heated everything around it to its kindling point. The construction of the building at this point was such that a two-foot deep areaway under the floor had a chimney-like effect which channeled and concentrated the high winds which spread the fire rapidly through the remaining portions of the building. These high winds rushed into the building through the drafty and missing windows on the eighth floor of the Fretz Building.

18. The heat generated by the dangerous electrical hookup was at its maximum at the elevator switchbox area of the Fretz Building but was prevalent along the entire electrical feed-in line with heat in intensity proportionate to nearness to the elevator switchbox. The hot feed-in wires caused fires on floors touched by the electrical feed-in lines, which fires were fed by air rushing at first through the drafty and missing windows and then by air surging in through windows broken by the fire, heat and pressure.

19. The wooden condition of the building, the intensely hot electrical fire, and the drafty condition of the building which fanned the initial flames, caused the fire to spread rapidly among the tons of combustible materials on the eighth floor and on the other floors beneath, until the fire, which was visible ten miles away, developed into a white hot fire storm of such intense heat that it ignited, by radiation alone, dwellings across the street from it and melted and warped the Reading Company's adjacent signal tower and rails and reduced its rail ties to ashes and threatened a general conflagration of disastrous proportions before it was finally brought under control by the maximum efforts

of five hundred eighty-six firemen and fifty-six fire companies.

20. The Receiver was responsible for this disaster and was negligent both through his own action and failure to act as Receiver and through the acts and failure to act of his agents, servants and employees:

a. in causing this fire to start;

b. in permitting its spread from the water tower area to other parts of the building and to other buildings and properties;

c. in failing to insure that the sprinkler system had been filled with an anti-freeze solution so that it would not freeze up and would remain operative even in cold weather;

d. in allowing the sprinkler system to become inoperative;

e. in failing to notify the Fire Department that the sprinkler system was inoperative;

f. in failing to take measures to restore the sprinkler system promptly;

g. in failing to post a fire watch in a building without fire protection;

h. in making a dangerous electrical connection;

i. in failing to turn off a dangerous electrical connection;

j. in failing to heat the Fretz Building adequately;

k. in failing to maintain the Fretz Building properly;

l. in failing to hire competent maintenance personnel;

m. in failing to instruct George Benezet not to make electrical connections which he was not qualified to make;

n. in failing to take measures to prevent the building from being unnecessarily drafty and therefore capable of supplying air for any embryonic fires that might start in the building;

o. in failing to take the precautions which would have been required of a reasonable man knowing that the building was drafty, that its interior was largely wood, that it was without sprinkler protection, in an area known as a fire risk area, and which housed an industrial complex with huge amounts of combustible materials.

For the above reasons, the above named claimant asks damages in the sum of Five hundred fifty-nine thousand seven hundred thirty and 83/100 Dollars, an itemized account of which is attached, and further asks that this claim be treated and allowed as a claim for administrative expenses.

WHITE & WILLIAMS
Counsel for Claimant

By W. WILSON WHITE

ITEMIZED ACCOUNT OF DAMAGES OF READING COMPANY

ITEM 1. DAMAGE TO READING COMPANY PROPERTY

(a) Tower building, with communication and interlocking equipment		$164,350.00
(b) Remove tower building		750.00
(c) Bridge 2/41—Fence, railings, walks		6,837.00
(d) Communication facilities		187.00
(e) Catenary and electrical system		32,052.00
(f) Track		89,776.00
(g) Signal facilities		158,281.83
(h) Engineering and supervision		11,450.00
(i) Train Describer System		12,000.00
		$475,683.83
Less estimated salvage		30,983.00
		$444,700.83

ITEM 2. EXPENSES INCURRED

Expense of crane used at fire scene for clearing damage and restoring track and catenaries (Port Richmond Terminal Expense):		
Labor	$1,513.86	
Crane Expense	3,842.59	
		$ 5,356.45
Operating Expenses — Philadelphia Division:		
a. Flagman at fire scene for 8⅓ days	$1,663.50	
b. Work trains, wire trains, engine changes	3,234.50	
c. McMyler Crane and Crew	313.87	
d. Crew and two extra yardmasters required at West Falls by reason of detour	171.78	
e. Extra crews and overtime at Reading Terminal	1,197.53	
f. Overtime for stationmasters, gatemen, train callers, baggagemen and clerks	1,912.00	

g. Extra men and overtime at towers	572.45	
h. Personal expenses of supervision	650.00	
		9,715.63
Operating Expenses—Reading and Shamokin Divisions:		
a. Engine crew allowance for detour move at Norristown—Jan. 1 through Jan. 6	64.80	
b. Crew expense in movement of light engine from Reading to Philadelphia on Jan. 1, 1963	77.23	
c. Change of crews at Shamokin on Train No. 97 on Jan. 1 as a result of Hours of Service Law	44.23	
d. Personal expenses of supervision	55.30	
		241.56
Police Department—Expense of police protection for passengers at detour points and policing fire scene		473.60
Motive Power Department:		
Erie Avenue Engine House. Wreckmaster supervised the use of self-propelled Diesel cranes from Port Richmond Terminal, taking up old rail affected by the fire; removing catenary structure and cleaning up the debris fallen on the railroad from the fire-damaged adjacent building	403.18	
Derrick Engineer using Relief train truck No. R-100 removing damaged catenary structure	57.99	
Port Richmond Car Shop. Assistant Foreman and Car Inspectors—Traveling and preparing damaged cars for removal	441.46	

Reading Terminal Carmen. Due to extra (shuttle) trains terminating at North Broad Street Station (caused by fire preventing full traffic to the Terminal), employees were sent to that point to inspect and service coaches, resulting in overtime charges to extent of..... 1,327.96

Huntingdon Street Car Shop. Car Inspectors, Electricians and Coach Cleaners worked at North Broad Street Station, 16th St. Junction and Wayne Junction Passenger Station, servicing extra (shuttle) trains—overtime 711.39

Wayne Junction Electric Car Shop. Employees were sent to outlying points to make running repairs and monthly inspections while cars were lying over at those points (prevented from being placed for attention at Car Shop) 4,369.70

Personal Expenses — Supervisory Personnel 170.12

7,481.80

The following expenses result from unloading cars at 5th & Willow Sts. Yard because of inability to transport beyond fire scene:

LLNX	4556—	Claim	340948-2...	$2,058.54
SUCX	230—	"	340949-2...	2,270.94
GEPX	1680—	"	341008-2...	1,824.50
URTX	67050—	"	341009-2...	1,490.69
HFPX	175—	"	341324-2...	1,021.42
URTX	67401—	"	341328-2...	1,468.89
LLNX	4522—	"	341323-2...	1,085.73
ART	91658—	"	341326-2...	729.03
URTX	60431—	"	341325-2...	829.32
NX	3149—	"	341327-2...	1,341.03
MNX	1855—	"	341329-2...	897.49

15,017.58

Cost of chartering buses to move passengers around fire scene:			
Philadelphia Transportation Co.	$4,311.00		
Reading Transportation Co.	2,671.25		
Merz Tours	917.50		
Auch Interborough	98.00		
Public Service	130.50		
Personal expenses	73.51		
		8,401.76	
			46,687.38

ITEM 3. DAMAGE TO CARS AND MERCHANDISE

Fire Damage to Freight Cars:			
URTX 69367—Destroyed	$7,500.00		
NX 1639—Damaged	175.00		
SHPX 20491—Damaged	225.00		
UP 125597—Damaged	450.00		
		8,350.00	
Merchandise in Freight Cars:			
Formal claims for fire damage to merchandise in cars received as follows:			
URTX 69367—Claim 339932-2	$8,507.29		
NX 1647— " 340944-2	2,388.54		
NX 1639— " 340945-2	2,492.86		
KGNX 3508— " 340946-2	2,331.69		
KGNX 3804, KGNX 3816 — " 340947-2	4,480.88		
		20,201.26	
			28,551.26

ITEM 4. PASSENGER DEPARTMENT LOSSES AND EXPENSES

Estimated revenue loss through service interruption Jan. 2 to 6, 1963, inclusive	$ 30,753.00		
Estimated revenue loss for period Jan. 7 to 11, inclusive	8,425.00		
Additional expenses	612.36		
			39,790.36
TOTAL			$559,730.83

PETITION TO EXPUNGE CLAIM

To the Honorable Thomas J. Curtin, Referee in Bankruptcy:
The Petition of FRANCIS SHUNK BROWN, 3rd, respectfully represents:

1. That he is the Trustee, duly qualified and acting.

2. That Claim #21 was filed by the Reading Company in the amount of $339,730.83.

3. That said claim was asserted to be a claim for administration expense due to the alleged negligence of the Receiver in the operation of the business of the Debtor in Chapter XI proceedings.

4. Your petitioner avers that said claim is not an administration expense inasmuch as it was not one of the actual and necessary costs and expenses incurred by officers other than the Referee in the administration of estates . . .", and hence, is not a cost of administration under Section 62(a)1 of the Bankruptcy Act.

WHEREFORE, your petitioner prays that the claim of the Reading Company be expunged, and that your petitioner have such other and further relief as is just.

/s/ FRANCIS SHUNK BROWN, 3RD

TRANSCRIPT OF SPECIAL MEETING OF CREDITORS

to Expunge Claim #21

Objection to Claims 14 and 160.

THE REFEREE: There has been filed by the Receiver-Trustee, because he has since become the trustee in bankruptcy a motion to expunge the claim.

Now, basically the motion to expunge alleges that the claim, asserted to be for administration expenses, is not an administration expense inasmuch as it was not one of the actual and necessary costs, and expenses incurred by officers other than the Referee in the administration of the estate—quoting Section 62-A-1 of the Bankruptcy Act, and, of course, that brings in question Section 64-A-1 also.

I understand that counsel for the Receiver-Trustee does not admit or accept the question of negligence, except for this particular hearing he states: Even if there was negligence it is still not an administration expense. Is that correctly stated so far?

MR. SHARKEY: Yes, sir.

MR. WHITE: Yes sir.

THE REFEREE: It would appear to me there is no factual question before the Referee. I think there should be a case stated and then briefs should be filed on the particular points. Hold them for a while. We have nothing before us except my direction which, of course, Mr. White is familiar with. I am proceeding like we did in Transport Clearings. We had there 162 different trucking outfits and we made one test case, and we are proceeding under the same theory. I think it is the only logical way. I think we have 150 claimants here also, and the same proposition of law is going to govern everyone; namely, if it is not an administration ex-

pense, of course, then it is not to be considered in this particular case. I believe that comes down almost basically to what we are going to go through here.

Now, I understand the Government wishes to be heard on this, because I think they come into the same category, as they are making the contention that if you come in as an administration expense, by virtue of priority, Section 64, it would, of course, push them back. And the same thing would happen to all the general claimants who are here, who have taken the same position, and if there are any wage claimants, of course, they would take the same position.

I also understand that Mr. Brown, representing the stockholders, also would be in the same position, because, naturally, if there is any overage it must go back to the stockholders. So I mean, you are going to be opposed by quite a few creditors in different categories. I think that the most orderly way to handle it would be to prepare a case stated within a certain period of time and have it framed, and anyone who does not like the Referee's ruling, of course, they would have the usual 10 days to file a certificate of review and proceed forward on it. Then, again, everyone should have an opportunity to file briefs in this matter.

Now, if you want to consult with your other counsel, you may. I think since it is your case, that is a matter for you to decide yourself. In other words, as far as this is concerned, while it is a test case it must, of course, be run by Mr. White who is the claimant here, namely, representing the claimant, The Reading Railroad.

MR. MARCU: Inasmuch as there are a number of claimants in this category, is it necessary for them all to join in Mr. White's claim or may they abide by the decision without joining in?

THE REFEREE: No, I have ruled. This will be the key or test case. When it is finally decided—because there is no

question about it—no one is going to be satisfied—in other words, there is too much money involved. There is no doubt about there having an appeal. Until it is ultimately decided, of course, all the other claims will remain in a state of flux or abeyance.

MR. ORLOFSKY: I am in the same category as Mr. White. You have indicated you will receive briefs from those opposing Mr. White's position. Now, I have the utmost confidence in Mr. White and I am certain he will present the legal issues and factual issues in the finest possible fashion, but will you also receive briefs from those who have similar interests as Mr. White?

THE REFEREE: No. I don't think I should at this time, because of the terrific number that are involved. In other words, I can't say that here I am going to receive a brief from you but not from counsel A, B, C, D, E, F, or G. There are a hundred and some claimants, represented by—I don't know how many lawyers—there must be at least 50 or 60 lawyers anyhow in this entire group, and I do not want to say that I am going to allow one counsel to file a brief on behalf of his claim and yet not allow another counsel. I think I am going to be governed by Mr. White in this respect.

* * * * *

CASE STATED

On November 16, 1962, I. J. Knight Realty Corp. (hereafter Knight Realty) filed a petition for an arrangement under Chapter XI of the Bankruptcy Act. On the same day, Judge Van Dusen appointed Francis Shunk Brown, 3rd, Esquire, as receiver and authorized him to operate the business of Knight Realty.

The only significant asset of Knight Realty was an eight-story industrial structure known as the Fretz Building, located at 10th & Diamond Streets, Philadelphia, Pennsylvania. The business of Knight Realty consisted of leasing space in the Fretz Building and operating the building for the benefit of its tenants.

On January 1, 1963, the Fretz Building was totally destroyed by a fire of unusual intensity. The conflagration spread to adjoining premises, damaging or destroying real and personal property of the Reading Company and others.

On April 3, 1963 the Reading Company filed a claim for $559,730.83 which it styled as a claim "for administrative expenses due to the negligence of the Receiver" in operating the business of Knight Realty. In essence, the Reading Company's claim alleges that the receiver, Francis Shunk Brown, 3rd, was negligent in permitting the fire to start and "spread beyond its normal confines." Thereafter, other fire loss claimants filed 146 additional claims for administration expenses based on the alleged negligence of the receiver in operating the business of Knight Realty. The total of all such claims exceeds $3,500,000. All of the well pleaded allegations of fact in the Reading Company's Statement of Claim are to be deemed true for the purposes of the Trustee's Motion to Dismiss or Expunge the Claim of the Reading Co.

On May 14, 1963, Knight Realty was adjudicated a bankrupt pursuant to a voluntary consent to adjudication filed on its behalf. Francis Shunk Brown, 3rd, was subsequently elected Trustee in Bankruptcy of Knight Realty.

The Trustee, Mr. Brown, has petitioned this Court to expunge the Reading Company's claim on the ground that it is not an administration expense within the meaning of the Bankruptcy Act. This Court's ruling on the Reading Company's claim for administration expenses will establish the law of case with respect to all other claims for administration expenses based on the alleged negligence of the receiver.

Other claims filed in this matter consist of federal tax claims of $244,953.91, and other tax claims of $70,823.19. Various other claims are as follows: secured, $230,619.04; unsecured, $76,905.47; and wages, $860.00. The Trustee, according to present estimates, will have between $630,000 and about $845,000 depending on the outcome of certain litigation against fire insurance companies presently pending.

/s/ OWEN B. RHOADS

/s/ SAMUEL MARX
Counsel for the Trustee

/s/ MICHAEL H. MALIN
for W. WILSON WHITE
Counsel for Reading Co.

REFEREE'S OPINION

SUR TRUSTEE'S MOTION TO EXPUNGE PROOF OF CLAIM OF THE READING COMPANY

There has been filed with the Referee a Case Stated, signed by Counsel for the Trustee and Counsel for the Claimant, but since other rights in this matter may be affected, and the Case Stated is short, the Referee sets it forth anew as his Findings of Fact.

CASE STATED

"On November 16, 1962, I. J. Knight Realty Corp. (hereafter Knight Realty), filed a petition for an arrangement under Chapter XI of the Bankruptcy Act. On the same day, Judge Van Dusen appointed Francis Shunk Brown, 3rd, Esq., as Receiver and authorized him to operate the business of Knight Realty.

"The only significant asset of Knight Realty was an eight-story industrial structure known as the Fretz Building, located at 10th & Diamond Streets, Philadelphia, Pennsylvania. The business of Knight Realty consisted of leasing space in the Fretz Building and operating the building for the benefit of its tenants.

"On January 1, 1963, the Fretz Building was totally destroyed by a fire of unusual intensity. The conflagration spread to adjoining premises, damaging or destroying real and personal property of the Reading Company and others.

"On April 3, 1963, the Reading Company filed a claim for $559,730.83, which it styled as a claim 'for administrative expenses due to the negligence of the Receiver' in operating the business of Knight Realty. In essence, the Reading Company's claim alleges that the Receiver Francis Shunk Brown, 3rd, was negligent in permitting the fire to start and 'spread beyond its normal confines.' Thereafter, other fire loss claimants filed 146 additional claims for administration expenses

based on the alleged negligence of the Receiver in operating the business of Knight Realty. The total of all such claims exceeds $3,500,000.00. All of the well-pleaded allegations of fact in the Reading Company's Statement of Claim are to be deemed true for the purposes of the Trustee's Motion to Dismiss or Expunge the Claim of the Reading Company.

"On May 14, 1963, Knight Realty was adjudicated a bankrupt, pursuant to a voluntary consent to adjudication filed on its behalf. Francis Shunk Brown, 3rd, was subsequently elected Trustee in Bankruptcy of Knight Realty.

"The Trustee, Mr. Brown, has petitioned this Court to expunge the Reading Company's claim on the ground that it is not an administration expense within the meaning of the Bankruptcy Act. This Court's ruling on the Reading Company's claim for administration expenses will establish the law of case with respect to all other claims for administration expenses based on the alleged negligence of the Receiver.

"Other claims filed in this matter consist of Federal tax claims of $244,953.91, and other tax claims of $70,823.19. Various other claims are as follows: Secured, $230,619.04; Unsecured, $76,905.47; and Wages, $860.00. The Trustee, according to present estimates, will have between $630,000.00 and about $845,000.00 depend[illegible] on the outcome of certain litigation against fire insurance companies presently pending."

QUESTION INVOLVED

Are tort claims against a Receiver under Chapter XI of the Bankruptcy Act, arising during the conduct of business of the receivership, allowable as administrative expense in an ensuing bankruptcy proceeding and entitled to priority in payment under Section 64(a)(1)?

DISCUSSION

The issue in the instant case is very simple, i.e., whether the claims of the Reading Company, and others similarly situated, are entitled to a first priority in payment as "costs and expenses of administration" pursuant to Section 64 (a) (1). If the claims fail under this Section, they are not allowable against the Bankrupt Estate in any category and the motion to expunge must be granted.

Section 64 of the Bankruptcy Act, as amended in 1962, provides, in pertinent part, as follows:

> "Section 64—Debts which have priority. a. The Debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition . . ."

The burden of proof rests upon the person asserting a priority under Section 64 (a) (1) to establish that his claim comes within the intended class.

In re American Anthracite v. Bituminous Coal Corp., 171 FS 377, affd. 280 F_2 219

In re Paradise Catering Corp., 36 FS 974

The brief of the Reading Company seems to be predicated upon the concept that, since the fire and any damage therefrom occurred subsequent to the appointment of the Receiver under Chapter XI, Bankruptcy Act, any damage resulting from negligence of the Receiver must necessarily be allowable as an expense of administration. This is an over-simplification of the problem and would require that the language of Section 62 and Section 64 (a) (1) of the

Bankruptcy Act be disregarded. In its brief, the Reading Company places considerable reliance upon a number of old railroad receivership cases. In addition, a case is cited involving an equitable receivership of a national bank where a receiver was appointed by the Comptroller of the Currency. None of these cases are helpful for the reason the pertinent sections of the Bankruptcy Act do not apply and the principal problem in the instant case is whether or not the Reading Company can bring itself within the purview of Section 64(a)(1).

In 1933, Congress recognized the peculiar problems involved in railroad reorganizations when it enacted Section 77 of the Bankruptcy Act. This Section codifies many of the equitable principles set forth in the cases cited by the Reading Company. For example, in *Meyer Rubber Company v. Georgetown and W. Railroad*, 174 F. 731 (1909), cited on page 5 of the Reading Company brief, it was held that the claim of an injured employee should be paid by the Receiver in an equity receivership as an administrative expense. This issue would now be controlled by Section 77(n) of the Bankruptcy Act, which specifically provides claims for injuries to employees of a railroad are to be given priority as administrative expenses. However, Section 77 has no application to the present proceedings. In enacting this Section, the Congress recognized the inherent danger in the operation of a railroad. If there had been any Congressional intention that the treatment accorded to certain limited categories of tort claims in railroad reorganizations by Section 77(n) should be applicable to Chapter XI proceedings or to ordinary bankruptcies, presumably at the same time that this Section was enacted, additional language could have and would have been added to Sections 62 and 64(a)-(1).

None of the cases cited in the Reading Company brief even purport to interpret Section 62 or Section 64(a)(1) of the Bankruptcy Act. I do not believe any of these cases will be helpful in resolving the issue.

Bunker Hill Country Club v. Robbins, 99 F. 2d 700 (C.C.A. 7th 1938) involves claims against a trustee in bankruptcy by certain persons to whom memberships in a country club had been sold. The opinion does not discuss tort claims and it appears the Court may have regarded these claims as contractual in nature. The Court stated in the opinion at page 702:

> ". . . it is inconceivable to us that an officer of the Court should be permitted to act, in what appears to be, in utter disregard of the rights of those with whom he had entered into contractual relations without making any provision for their protection."

There is also an element of unjust enrichment in the *Bunker Hill* case inasmuch as the Trustee, in effect, sold the same property twice. The issue in the instant case is not discussed.

There is a quotation on page 4 of the brief of the Reading Company from the opinion of Judge Learned Hand in the case of *Vass v. Conron Brothers Co.*, 59 F. 2d 969, 971 (C.C.A. 2d, 1932), but this is dictum and has no relationship to the issue decided by the Court. In that case, the Court affirmed an order of the district court enjoining an action against the Receiver that had been brought in state court. It is stated in the opinion on page 970:

> ". . . the lessee sued him (the Trustee) in the state court individually, as Receiver, and as Trustee, alleging that he had assumed the covenants in the lease, and that between July 10th and August 15th, he had failed to refrigerate the premises, so that perishable goods had spoiled. There is also a count for 'negligence', but this adds nothing."

There is nothing in this opinion to indicate that Judge Hand regarded the claim as a tort claim and there is no discussion of the applicable bankruptcy sections.

The only other bankruptcy case cited in the brief of the Reading Company is *In re Progress Lektro Shave Corp.*, 35 F. Supp. 915 (D. Conn., 1940). This case involves a

claim for a patent infringement and has no relevance to the problem in the instant case. It appears from the opinion that this case is based upon an unjust enrichment theory inasmuch as the Trustee sold property under circumstances that interfered with the property rights of the claimant.

The Federal Bankruptcy Law governs in this situation.

American Surety Co., v. Sampsell, 327 U. S. 269

Provisions of this Section relative to costs and expenses are to be strictly construed in aid of economy in administration of the bankrupt estate.

In re Rothman 85 F_2 51

In re Sleep Products, Inc., 242 F_2 375

The broad purpose of Section 64(a)(1) is to bring about an equitable distribution of the bankrupt's estate and if one claimant is to be preferred over another, the purpose should be clear from this Section.

U. S. v. Embassy Restaurant, Inc., 359 U. S. 29

Guenin v. Weill, Gothel, etc., 205 F_2 302

It seems reasonably evident that the purpose of the priority for administrative expenses is to permit the Receiver or Trustee to incur ordinary and necessary contractual obligations for the preservation of the assets of the estate. There is no such thing as a "necessary" tort claim, as the word "necessary" means what is reasonably advisable in order to preserve the estate of the bankrupt.

In re Hoffman, F. S. 245

In a recent opinion (Filed August 12, 1964), the Third Circuit, in the matter of Connecticut Motor Lines, Inc., No. 14645, had before it the construction of Section 64(a)(1). Certain excerpts from the opinion are so pertinent, the Referee quotes them:

"In all cases cited, the trustee or bankrupt was taxed on activities involved in further developing the bankrupt's assets or in seeking to maintain such assets for the maximum benefit of creditors. Post-bankruptcy taxation such as this had long been viewed by the courts as part of classic administration expenses.

"Thus, as the tax on such wages as is before us neither has a relationship to the cost of protecting or developing the bankrupt's assets, nor can be reasonably considered a tax on the mere distribution of the wages, Section 64(a)(1) of the Bankruptcy Act is distorted by attempting to create a fiction as was done in *United States v. Fogarty*.

"The Government's argument amounts to a bland assertion that all post-bankruptcy expenses, including taxes, are by definition first priority costs and expenses of administration.[15] There has been an unwillingness to recognize that Section 64(a)(1) does have built-in limitations. A few courts, however, have been aware of this problem and the considerations to be weighed in classifying an expense as a Section 64(a)(1) first priority matter.

"*In re Mt. Washington S.S. Co., Inc.*[16] involved the levy of a use tax on an uncompleted sailing vessel four days after the filing of the bankruptcy petition. The bankrupt's assets were insufficient to reach fourth priority creditors. The city, therefore, argued that as the tax accrued after the filing of the bankruptcy petition, a post-bankruptcy expense entitled to first priority status arose. The federal district court held that because the trustee neither operated the boat nor

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[15] The question of whether we are in fact dealing with a post-bankruptcy tax will be dealt with subsequently in the opinion. The point to be made at this time is that all post-bankruptcy expenses are not necessarily costs and expenses of administration. As this case is limited to the question of taxes, other non-first priority post-bankruptcy expenses will not be explored herein.

[16] 43 F. Supp. 176 (D.N.H. 1942).

was ever apparently authorized to operate the boat, the tax assessed could not be considered a current expense of administration.[17]

"*In Denton & Anderson Co., v. Induction Heating Corp.*,[18] a creditor-agent of the bankrupt secured orders for the bankrupt's goods prior to filing of the bankruptcy petition. The bankrupt accepted the orders, but had not filled them prior to the filing. After the filing, the bankrupt was allowed to remain in possession and operate his business, at which time the orders were filled and the creditor-agent's commissions arose upon the bankrupt's being paid for the orders. The creditor claimed that because his commissions were post-bankruptcy expenses, they were entitled to first priority status as an expense of administration. The United States Court of Appeals for the Second Circuit refused to expand 'costs and expenses of administration' to encompass such an item which merely was a post-bankruptcy expense separate and distinct from development or preservation of the bankrupt's estate, and an expense which could not be placed in the category of costs incurred because of the bankruptcy distribution.[19]

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[17] The court further indicated that because the bankrupt's assets were limited and insufficient to satisfy fourth priorities, the question of such tax fitting into that level of priority was purely academic and not worthy of discussion.

[18] 178 F. 2d 841 (2 Cir. 1949).

[19] Judge Frank stated:

". . . appellant (creditor) could at once—under Bankruptcy Act, Section 57, sub.d and 63, sub.a(8)—have filed a claim either (1) as an unliquidated claim or (2) as a contingent claim. . . . (T)he only possible questions were (a) whether the amount of the claim could be determined, and if so, (b) what the amount was. . . ."

Id. at 843. Subsequent discussion will indicate that the questions as to the possible determination of the amount of the claim and its establishment in this case are substantially similar to those which have been faced by the Second Circuit. See text, pp. 17-18.

"In both the aforementioned cases the tax or expenses was post-bankruptcy and the trustee or bankrupt was either in possession of the item taxed or operating the business from which operation the expense. *In re Mt. Washington S.S. Co., Inc.*, involved a matter entirely arising after the filing of the petition, *Denton & Anderson Co., v. Induction Heating Corp.*, was a hybrid situation, such as the one before us now. Yet, in both circumstances, the courts went beyond the mere fact of the tax or expense arising after the initiation of the bankruptcy to analyze whether such tax or expense could be reasonably considered to be a first priority cost or expense of administration. Approaching the problem in a like manner, we find the rubric 'costs and expenses of administration' to be distorted essentially when withholding and social security taxes based on labors terminated prior to bankruptcy are forced into a Section 64(a)(1) priority position.

"Our view of the boundaries of Section 64(a)(1) of the Bankruptcy Act is reinforced by the latest amendment to that Section in 1962. Prior to the 1962 amendment, Section 64(a)(1) set forth a number of individual first priority expense items under no explicit generic label. 'Costs and expenses of administration' was one of a number of particular items enumerated in Section 64(a)(1).[20] In such a posture, the Sec-

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[20] Bankruptcy Act, Section 64(a)(1), 11 U. S. C., Section 104(a)(1) (1958):

"(a) The debts to have priority, in advance of the payments of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and expenses of one or more creditors, the reasonable costs and expenses

tion did lend itself to a broad construction. The amendment altered the language of the Section to read as follows:

"(a) the debts to have priority in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; . . . ." [21]

"The impact of the amendment was to clarify the fact that Congress had considered all expenses laid out in Section 64(a)(1) costs and expenses of administration. The legislative history makes it clear that Congress, through the amendment, wanted to underline this factor. The Senate Report [22] accompanying the amending legislation stated:

"Section 6

"(a) The first priority under Section 64(a) is frequently referred to as the 'administration expense priority.' All of the items set forth in Section 64(a)-(1) are properly regarded as 'costs and expenses of administration.' Even as clause (1) read in the Chandler Act amendment of Section 64, however, the quoted expression did not appear in the language of the clause until three separate items were mentioned."

* * *

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of such recovery; the cost and expenses of administration including the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under Chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; . . ." (Emphasis added.)

[21] Bankruptcy Act, Section 64(a)(1), 11 U. S. C., Section 104(a)(1) (Supp. V. 1964). (Emphasis added.)

[22] Senate Report No. 1954, accompanying the amending legislation, H. R. 5393, August 28, 1962.

"The transposition of the words, 'the costs and expenses of administration, including,' to the beginning of Section 64(a)(1), as proposed in the suggested amendment, will make clear the intended result.

"Though those enumerated costs and expenses of administration were never meant to be all inclusive, the 1962 amendment does indicate a concern that a meaningful view be had as to what is to be considered a cost and expense of administration. By explicitly structuring Section 64(a)(1) the Congress indicated both that all items in Section 64(a)(1) were costs and expenses of administration, and that the expression 'costs and expenses of administration' was not a catchall within the first priority. With such a Congressional intent apparent, it is preferable to isolate from Section 64(a)(1), as falling without a meaningful view of costs and expenses of administration, those expenses which, though they can be considered post-bankruptcy items, are unrelated to development, preservation or distribution of the bankrupt's assets."

Since it is the clear view of the Referee, in consideration of the foregoing, that the claim is not an administrative expense claim, nor is it an unsecured claim against the bankrupt estate, the motion to expunge the claim from the docket is hereby granted, and an appropriate order will be entered herein, the claim not having been proven it will not be allowed.

CONCLUSIONS OF LAW

1. The claim of the Reading Company, not having been proved, is not allowed as an administrative expense claim.

2. The claim of the Reading Company, not having been proved, is not allowed as an unsecured claim.

3. The claim of the Reading Company is expunged from the record in this case.

/s/ THOMAS J. CURTIN
Referee in Bankruptcy

Dated at Philadelphia, Pa.,
this 30th day of September, 1964

REFEREE'S ORDER

AND NOW, to wit, this 30th day of September, 1964, in conformity with the aforesaid Opinion,

the Motion to Expunge the Claim of the Reading Company, hereinbefore filed in this case, is hereby granted, and the Claim is stricken from this record.

/s/ THOMAS J. CURTIN
Referee in Bankruptcy

PETITION FOR REVIEW

To the Honorable Thomas J. Curtin, Referee in Bankruptcy:

1. Petitioner is The Reading Company, a corporation, which has filed a proof of claim for administrative expenses in the above proceeding.

2. On September 30, 1964, your Honor entered an Order herein as:

> "AND NOW, to wit, this 30th day of September, 1964, in conformity with the aforesaid Opinion,
>
> the Motion to Expunge the Claim of the Reading Company, hereinbefore filed in this case, is hereby granted, and the Claim is stricken from this record."

The aforesaid Order was based upon findings that:

> "1. The claim of the Reading Company, not having been proved, is not allowed as an administrative expense claim.
>
> 2. The claim of the Reading Company, not having been proved, is not allowed as an unsecured claim.
>
> 3. The claim of the Reading Company is expunged from the record in this case."

3. The said findings are erroneous in that the Reading Company is entitled as a matter of law to prove the negligence liability of the Receiver and Trustee and upon proof of liability in accordance with state law, to have such liquidated amount allowed as an administrative expense of the estate of the bankrupt.

WHEREFORE, petitioner prays that Your Honor certify to the judge of this court and transmit to the clerk the record in said proceedings having to do with, or in any manner bearing upon, the order aforesaid, as provided in §39 of the Bankruptcy Act.

WHITE AND WILLIAMS
Attorneys for Reading Company

By /s/ W. WILSON WHITE
/s/ MICHAEL H. MALIN

OPINION OF THE DISTRICT COURT

VAN DUSEN, *J.* June 9, 1965

This case is before the court upon the petition of the Reading Company to review an order of the Referee in Bankruptcy, expunging a claim filed by the Reading Company asking for damages allegedly caused by the negligence of the Receiver in carrying on the business of the bankrupt (pp. 34 and 35 of Document 8). Petitioner seeks to have its claim, based on losses suffered in a fire which started on the bankrupt's property, allowed as a priority claim for administrative expenses under §64(a)(1) of the Bankruptcy Act, 11 U. S. C. §104. Petitioner is but one of over a hundred claimants who have filed proofs, but it has been agreed that the instant case is a test case which will decide the right of all claimants to prove their claims as administrative expenses.

The CASE STATED, as filed with the Referee and signed by counsel for the Trustee and counsel for the claimant, is as follows:

> "On November 16, 1962, I. J. Knight Realty Corp. (hereafter Knight Realty) filed a petition for an arrangement under Chapter XI of the Bankruptcy Act. On the same day, Judge Van Dusen appointed Francis Shunk Brown, 3rd, Esquire, as receiver and authorized him to operate the business of Knight Realty.
>
> "The only significant assets of Knight Realty was an eight-story industrial structure known as the Fretz Building, located at 10th & Diamond Streets, Philadelphia, Pennsylvania. The business of Knight Realty consisted of leasing space in the Fretz Building and operating the building for the benefit of its tenants.
>
> "On January 1, 1963, the Fretz Building was totally destroyed by a fire of unusual intensity. The conflagration spread to adjoining premises, damaging

or destroying real and personal property of the Reading Company and others.

"On April 3, 1963, the Reading Company filed a claim for $559,730.83 which it styled as a claim 'for administrative expenses due to the negligence of the Receiver' in operating the business of Knight Realty. In essence, the Reading Company's claim alleges that the receiver, Francis Shunk Brown, 3rd, was negligent in permitting the fire to start and 'spread beyond its normal confines.' Thereafter, other fire loss claimants filed 146 additional claims for administration expenses based on the alleged negligence of the receiver in operating the business of Knight Realty. The total of all such claims exceeds $3,500,000. All of the well pleaded allegations of fact in the Reading Company's Statement of Claim are to be deemed true for the purposes of the Trustee's Motion to Dismiss or Expunge the Claim of the Reading Co.[1]

"On May 14, 1963, Knight Realty was adjudicated a bankrupt pursuant to a voluntary consent to adjudication filed on its behalf. Francis Shunk Brown, 3rd, was subsequently elected Trustee in Bankruptcy of Knight Realty.

"The Trustee, Mr. Brown, has petitioned this Court to expunge the Reading Company's claim on the ground that it is not an administration expense within the meaning of the Bankruptcy Act. This Court's ruling on the Reading Company's claim for administra-

[1] The case is now before the court in a situation similar to that where the defending party has filed a motion to dismiss (to be treated as one for summary judgment under F. R. Civ. P. 12(b), which is made applicable by General Order in Bankruptcy 37) on a record which concedes a factual issue which will have to be determined by trial if the motion to dismiss is denied. The factual issue conceded for purposes of this Motion is whether or not the Receiver was negligent. The undersigned rejects the apparent contention of the Government that suit for the damage claimed by Reading Company could not be brought, as a matter of law, under 28 U. S. C. §959(a) on the basis of this record.

tion expenses will establish the law of case with respect to all other claims for administration expenses based on the alleged negligence of the receiver.

"Other claims filed in this matter consist of federal tax claims of $2,444,953.91, and other tax claims of $70,823.19. Various other claims are as follows: secured, $230,619.04; unsecured, $76,905.47; and wages, $860.00. The Trustee, according to present estimates, will have between $630,000 and about $845,000 depending on the outcome of certain litigation against fire insurance companies presently pending."

There are two questions presented by the facts of the case at bar:

(A) The principal question is whether the Reading Company's claim comes within "the costs and expenses of administration" of § 64(a)(1) of the Bankruptcy Act.

(B) If the answer to (A) is in the negative, does the Reading Company still have a "provable" claim so that the Referee should not have expunged it.

A. "Costs and expenses of administration"

(§ 64(a)(1) of the Bankruptcy Act, as amended—11 U. S. C. §104(a)(1))

The claim of the Reading Company does not fall within the above-quoted language of § 64(a)(1) of the Bankruptcy Act, as amended to December 1962, for these reasons:

1. The claim does not fall within the language of the Act, strictly construed

Section 64 of the Bankruptcy Act, as amended in 1962, provides in pertinent part as follows:

> "§ 64. Debts Which Have Priority. a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; . . . ."

Where statutes involving priorities are in issue, a strict construction must be placed thereon and the burden falls upon those asserting the priority to establish that their claim falls within the class of those intended to be preferred. *In re American Anthracite and Bituminous Coal Corp.*, 171 F. Supp. 377, 381-2 (S. D. N. Y. 1959), aff'd. 280 F. 2d 119 (2nd Cir. 1960).

Since this claim is not "an actual and necessary cost and expense of preserving the estate," there is no specific authority for paying this claim. Where no explicit authority exists in the Bankruptcy Act for allowance of expenses out of the bankrupt's estate, such an allowance is appropriate only in exceptional cases. *In re Friedman*, 232 F. 2d 151 (2nd Cir. 1956); *Guerin v. Weil, Gotshal & Manges*, 205 F. 2nd 302 (2nd Cir. 1953).

2. The legislative history of the Bankruptcy Act requires that § 64(a)(1) may not be construed to apply to this claim.

(a) Since Congress has shown by its inclusion of the following language in § 77(n) (11 U. S. C. § 205(n)) of the Bankruptcy Act in 1933 [2] that it uses specific language where it intends to prefer negligence claims and have them paid as operating expenses and, by its failure to include such language in § 62 or 64 of the Bankruptcy Act

[2] The present §77(n) was titled §77(s) in 1933. It was renumerated to §77(n) in 1935 and amended in 1939 to include preferences for railroad employees holding tort claims in equity receiverships.

in any of the several revisions of these sections since 1933, that there is a Congressional intent not to treat such tort claims as operating expenses and not to give them a preference, § 64(a)(1) does not cover this claim by Reading Company:

> "In proceedings under this section, and in equity receiverships of railroad corporations now or hereafter pending in any court of the United States, claims for personal injuries to employees of a railroad corporation, claims of personal representatives of deceased employees . . . brought against such railroad corporation . . . shall be preferred and paid out of such railroad corporation as operating expenses of such railroad."

Authorities have recognized generally the significance of the special provision in § 77(n) applying to railroads. In 5 Collier on Bankruptcy, § 77.21, at page 568, the following statement appears:

> "It is extremely doubtful, however, if § 64, governing priorities in ordinary bankruptcy, can be considered generally applicable. The classification of priorities there set forth is not adaptable to railroad reorganization, ..."

See, also, *In Re Hudson & Manhattan Railroad Company*, 178 F. Supp. 103 (S. D. N. Y. 1955); aff'd. 273 F. 2d 707 (2nd Cir. 1960).[3]

(b) The legislative changes to § 64(a)(1) require its limitation to the type of expenses specified in that section and to claims for expenses of preserving the bankrupt's estate.

In the 1952 Congressional Reports concerning the part of § 64(a)(1) relating to priorities to be given to admin-

[3] It was held that tort claims were not entitled to a priority since §77(n) did not apply to the debtor.

istration expenses in ensuing bankruptcies, Congress made clear that administration expenses to be given priorities were those that would prevent "a breakdown of administration."[4] A similar Congressional Report in 1962 accompanying the bill which adopted § 64(a)(1), as quoted at page 4 above, made clear that the enumerated expenses in the section as worded in 1962 are the type of "costs and expenses of administration" contemplated.[5] The United States Court of Appeals for the Third Circuit has emphasized that the legislative history of this section requires that these "costs and expenses" must be related to "development, preservation or distribution of the bankrupt's estate," using this language in *In Re Connecticut Motor Lines, Inc.*, 336 F. 2d 96, 102 (3rd Cir. 1964):

> ". . . Congress indicated both that all items in Section 64, sub. a(1) were costs and expenses of administration, and that the expression 'costs and expenses of administration' was not a catchall within the first priority. With such a Congressional intent apparent, it is preferable to isolate from Section 64, sub. a(1), as falling without a meaningful view of costs and expenses of administration, *those expenses which, though they can be considered post-bankruptcy items, are unrelated to development, preservation or distribution of the bankrupt's assets.*" (Emphasis supplied.)

Allowance of claims such as petitioner's will not "develop, preserve or distribute this estate" but in cases such

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[4] See Senate Report No. 1395, 82nd Cong., 2d Sess. (1952) 4, which states in part:

> ". . . Unless provision is made for payment of the costs and expenses necessary to liquidate, administer and close the estate in the ensuing bankruptcy proceeding, ahead of all prior incurred and unpaid administration costs and expenses, there is always danger of a breakdown of administration. . . ."

[5] See Senate Report No. 1954, accompanying the amending legislation, H. R. 5393, August 28, 1962, U. S. Code, Congressional and Administrative News, p. 2603 (1962).

as this would decimate it with $3,500,000. of claims. The undersigned agrees that the repairing of these pipes in the Fretz Building is an activity related to the preservation of the bankrupt's assets and the cost of such activity would be an expense of administration. However, damage caused by any fire resulting from the negligent manner in which this activity was carried on can hardly be considered an expense related to the preservation of the bankrupt's assets. Specific language should be secured from Congress to accomplish the result sought by the Reading Company, just as Congress acted in 1962 to cover specifically the claims disallowed in *Guerin v. Weil, Gotshal & Manges*, supra, at 305.[6]

The Supreme Court, in discussing the subordination by § 67(c) of certain secured liens to the claims under § 64(a)(1) and (2), stated in *Goggin v. California Labor Div.*, 336 U. S. 118, at 127 (1949):

> "The background of § 67c suggests a conscious purpose to give a narrowly limited priority to administrative expenses and to certain wage claims . . . ."

The Supreme Court based the above statement on a part of the legislative history of § 67(c) indicating that such "narrowly limited priority" was necessary to secure effective administration of the bankruptcy law. This part of

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[6] Senate Report No. 1954, referred to in footnote 5 above, contains this language (see p. 2608 of 1962 U. S. Code, Congressional and Administrative News):

> "The expenses of petitioning creditors who have obtained an adjudication after a contest constitute a proper cost and expense of administration. These expenses should include compensation paid to accountants and appraisers whose services were necessary. In the case of Guerin v. Weil, Gotshall & Manges, (205 F. 2d 302 (2d Cir. 1953)), the court disallowed such expenses, however, and suggested that their inclusion would require specific congressional action (205 F. 2d at 302). This inclusion would be accomplished by the proposed amendment of section 64a(1), which adds new language immediately preceding the proviso."

the legislative history relevant to the case at bar quoted by the Supreme Court is (see footnote 8, p. 128):

> " 'It is significant that in recent years state legislatures have been enacting special legislation in favor of tax claims, public debts, and a variety of private claims. Statistics in the bankruptcy cases show that the effective administration of the bankruptcy law has seriously suffered therefrom. Such claims . . . consume the entire estate, leaving nothing for the payment of the costs and expenses of administration incurred in reducing the assets to cash . . . .
>
> " 'There is therefore need for a provision to protect the administration costs and expenses; . . . .' " (From an explanatory note attributed to Jacob I. Weinstein in a Committee Report Analysis of H. R. 12889, 74th Cong., 2d Sess. (1936), cited at 336 U. S. 127-9.)

Thus, administration costs and expenses are those which promote effective administration of the bankruptcy law. Petitioner's claim is not such a cost or expense.

3. The decided cases indicate a holding that this claim does not fall within the scope of §64(a)(1).

There are no cases which have directly considered the issue raised by the facts on this record. However, there are two Circuit Court of Appeals cases which indicate that a tort claim is not an administrative expense within §64(a)-(1). *In Re Hudson*, supra,[7] held that tort claims which arose after the filing of a petition were not entitled to a priority as an administrative expense where the proceeding was a Chapter X reorganization. The claimants argued that the bankrupt qualified as a railroad corporation and that they, therefore, fell within §77(n) of the Bankruptcy Act. Although §64(a)(1) was not discussed, the court implicit-

[7] The opinion relied on in this case is by the District Court and it was affirmed by the Second Circuit, 273 F. 2d 708.

ly held that tort claims were not entitled to a priority under that section when it held that the bankrupt was not a railroad corporation and that the claimants were consequently not entitled to priority as an operating expense. *In re Connecticut Motor Lines, Inc.*, supra, is indicative of the narrow view that the Court of Appeals for the Third Circuit has taken of the scope of §64(a)(1). Although this case was not concerned with the issue of whether or not tort claimants were entitled to a priority under this section, its holding did limit this section to only those post-bankruptcy expenses which are related to development, preservation or distribution of the bankrupt's estate. As discussed above, the undersigned is of the opinion that the instant petitioner's claim is not such an expense.

B. The Referee correctly expunged the Reading Company's claim from the record.

Since the Reading Company's claim does not qualify as an administration expense, the Referee was correct in expunging it from the record, as it was not provable as an unsecured claim under §63 of the Bankruptcy Act, 11 U. S. C. §193. "In order to be entitled to a *pro rata* share in the estate, a claim must have been allowed, and allowance depends first of all upon due and timely proof and filing." 3 Collier on Bankruptcy, 14th Ed., §63.05, at p. 1780. Section 63, entitled "Debts Which May Be Proved," states that negligence actions must be instituted prior to and be pending at the time of filing the petition in bankruptcy in order to be provable. The date of the filing of the petition in bankruptcy is considered to be November 16, 1962, the date of the filing of the petition under Chapter XI, §378, of the Bankruptcy Act, 11 U. S. C. §778. Since the fire occurred on January 1, 1963, all actions and claims for the alleged negligence have been filed subsequent to the filing of the petition in bankruptcy. Thus, any claim of the Reading Company arising out of this fire is

not provable as an unsecured claim under §63 of the Act and, therefore, not entitled to a pro rata share of the estate.

The Referee properly expunged the Reading Company's claim from the record.

The able briefs of the parties have been filed as Documents 9-12. Comments on several cases relied on by the Reading Company are contained in Appendix A.

ORDER OF THE DISTRICT COURT

AND NOW, June 9, 1965, IT IS ORDERED that the Petion for Review of the Reading Company, certified by the REFEREE'S CERTIFICATE FOR REVIEW dated October 9, 1964, is DENIED and that the Order of the Referee dated September 30, 1964, is AFFIRMED.

/s/ FRANCIS L. VAN DUSEN, J.

Appendix A

TO MEMORANDUM OPINION AND ORDER OF JUNE 1965

Petitioner first asserts that all the text writers agree that tort damage claims are allowable as administrative expenses. After this assertion, petitioner quotes from four different sources which generally state that damages from torts arising during the period that a business is being operated by a receiver are considered a part of the operating expense of the receivership. However, the statements of these writers, when taken in context, are concerned with the broad range of receiverships in general and none of the cases cited as authority by the writers for the quoted statements are at all similar to the case at bar.[1] The cases relied on deal mainly with railroad receiverships or state receiverships, and none of them discusses the allowance of tort damages during bankruptcy as priority claims under §64(a)(1). Of the several cases cited by the petitioner, only two of them discuss the interpretation of "costs and expenses of administration" as that phrase is used in §64(a)(1): *In re Progress Lektro Shave Corp.*, 35 F. Supp. 915 (D. Conn. 1940); and *In re Connecticut Motor Lines, Inc.*, 336 F. 2d 96 (3rd Cir. 1964). Neither of these cases is concerned with the issue of whether tort damages suffered during the period of operation of a business by a Receiver or Trustee are administrative expenses. Other

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[1] E.g., 3 Collier on Bankruptcy, §62.15, p. 1540:

"Among other expenses incident to conducting a business and therefore allowable as administrative expenditure may be . . . payments of claims for personal injuries inflicted in the operation of a business. . . ."

The case relied on in the footnote for this statement held that a personal injury claim accrued during the operation of a railroad by a receiver was a cost of administration. Railroad reorganizations have been specifically recognized to have peculiar problems and the cases allowing these tort claims to be costs of administration are based on §77(n), not §64(a)(1) (see part A-2(a) of the foregoing opinion).

cases cited do concern themselves with whether such claims are administrative expenses, but do not discuss whether or not such are allowable under the section in question.

Cases Where Estate Profited From Tort Claim

In *In re Progress Lektro Corp.*, supra, relied on by the petitioner, the facts are distinguishable from the instant case as there a trustee sold for the benefit of the estate an article covered by the claimant's patent, thus depriving the patentee of his exclusive right of sale. The court found this to be a violation of the patent laws and it held the plenary powers of Congress in the field of bankruptcy to be subject to the guarantees of the patent laws. In other words, the money received by the estate for the sale of this patented article in reality belonged to the patentee and to have denied him a priority would have been to deny him the right to his own property. In the case at bar, there has been no appropriation to the benefit of the estate of the petitioner.

Bereth v. Sparks, 51 F. 2d 441 (7th Cir. 1931), is similarly distinguishable. This case is concerned with a bank receivership and not with §64(a)(1), but will be discussed for purposes of relevancy as to what constitutes "costs and expenses of administration." In *Bereth*, the claim arose out of a bank's unlawful attachment of the claimant's personal property. Subsequent to such attachment, the bank was placed in receivership. The claimant sued the receiver in a replevin action and recovered possession of the property. If that claim had been denied a priority, as in the *Lektro Corp. case*, supra, the claimant would have been denied access to his own property.

In another case relied on by petitioner, *In re Hunter*, 151 Fed. 904 (E.D. Pa. 1907), the court allowed a claim for loss of rent where a trustee, just prior to the sale of the bankrupt's property, intentionally refused to remove the bankrupt's property for the purpose of avoiding the removal expense. The court stated that this claim could not

be proved under §63, but did not state why the claim was being allowed. The court held that the trustee was personally liable on the landlord's claim, but that the estate was liable over to the trustee, "the estate having profited from the trespass." Thus, this case is not authority for the proposition that tort damages arising during receivership are costs of administration because such is not discussed in the case and, even if the damages recovered were allowed as costs of administration, it would have been on the theory that these damages were accrued as "a cost of preserving the estate." If recovery is allowed in the instant case, it cannot be on the theory that the damages were intentionally accrued in order to preserve the estate.

Other Cases Relied On By Petitioner

Petitioner places heavy reliance on a statement by Judge Learned Hand in *Vass v. Conron*, 59 F. 2d 969, at 971 (2nd Cir. 1932).[2] In that case, a state court action against a receiver and trustee was enjoined as being in an improper forum. The undersigned agrees with the Referee that the statement relied on by petitioner was dictum and rejects the petitioner's contention that Judge Hand could not constitutionally enjoin the action in the state court without discussing what comprises an administrative expense.

Two other cases cited by the petitioner in support of its contention that its tort claim should be accorded priority are *Cowdrey v. Galveston, etc. R. R. Co.*, 93 U. S. 352 (1876), and *Farmers' Loan and Trust Co. v. Northern Pac. R. Co.*, 74 Fed. 431 (D. Ore. 1896). Both of these are cases involving railroads in receivership. Once again, neither involves the question of interpreting §64(a)(1), but both are cited for their relevance to the determination of ad-

[2] ". . . the liquidation of the lessee's resulting damages was as much a part of the usual administration in bankruptcy, as that of the pay of accountants, custodians or other assistants, employed by the trustee."

ministration expenses during receiverships in general. In many old cases railroads in receivership allowed negligence claims as administrative expenses. However, as discussed in the foregoing opinion (part A-2(b)), the enactment of §77 of the Bankruptcy Act in 1933 was a recognition by Congress of the peculiar problems entailed in the reorganization of railroads engaged in interstate commerce.[3]

[3] In its reply brief, petitioner cited one other case, *Valdes v. Feliciano*, 267 F. 2d 91 (1st Cir. 1959), which it feels is significant because of a statement made by Judge Hastie in the opinion. As noted by the letter of counsel for the trustee in bankruptcy dated March 8, 1965 (attached to Document 9), no significance may be attached to the quoted statement because it starts with the words "It is argued that . . .", thus showing that the court there was considering the claim as an administrative expense only in a hypothetical sense. Further, the claim was against a railroad receiver.

Opinion of the U.S. Court of Appeals

(Filed January 6, 1967)

Argued May 5, 1966

Reargued December 8, 1966

Before STALEY, *Chief Judge* and MCLAUGHLIN, KALODNER, HASTIE, SMITH, FREEDMAN and SEITZ, *Circuit Judges*

By KALODNER, *Circuit Judge*

The issue presented on this appeal is whether appellant's claim, if proved, is entitled to the priority status accorded to costs of administration by Section 64, sub.a(1) of the Bankruptcy Act.[1]

The facts are not in dispute, and have been stipulated. In substance, they are as follows:

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[1] "Sec. 64. Debts which have priority.

"a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; . . . Where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superceded proceeding and in the suspended bankruptcy proceeding, if any; . . ." Bankruptcy Act, §64 sub.a(1), 11 U.S.C.A. §104, sub.a(1), Sept. 25, 1962, 76 Stat. 571.

On November 16, 1962, I. J. Knight Realty Corp. filed a petition for arrangement under Chapter XI of the Bankruptcy Act. On the same day, the District Court appointed a Receiver and authorized him to operate the debtor's business, which consisted principally in the leasing of the debtor's eight-story industrial building in Philadelphia. On January 1, 1963, this building was destroyed by a fire which spread to adjoining premises and caused damage to real and personal property of The Reading Company, appellant herein, and of others.

On April 3, 1963, appellant filed a claim for damages in the amount of $559,730.83, alleging that the receiver was negligent in permitting the fire to start and "to spread far beyond its normal confines." The claim specifically recited that it was "for administrative expenses due to the negligence of the Receiver in operation of business of the debtor." Other claimants have filed 146 additional claims, similarly grounded and similarly seeking priority status as administration expenses, totalling in excess of $3,500,000. Those claims are held in abeyance by the Referee pending the ultimate disposition of the claim now on appeal.

On May 14, 1963, the debtor was voluntarily adjudicated a bankrupt. A Trustee was elected, and he moved to expunge appellant's claim on the ground that it was not an administration expense under Section 64, sub.a(1) of the Bankruptcy Act.[2] The Referee expunged the claim. On

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[2] The stipulation of the parties, entitled "Case Stated", is set out at 242 F. Supp. at 338-339. It appears therefrom that the Trustee will have for distribution between $630,000 and $845,000, depending on the outcome of pending litigation against fire insurance companies. The status of the instant claim becomes important particularly to the United States, which has a substantial priority claim under Section 64, sub.a(4).

petition for review, the District Court concluded that the claim was not entitled to priority as an administration expense under Section 64, sub.a(1).[3] 242 F. Supp. 337 (E.D. Pa. 1965).

We are of the opinion that the Order of the District Court should be affirmed.

The right of a claim to priority status in a Chapter XI proceeding is controlled exclusively by Section 64 of the Bankruptcy Act by virtue of the provisions of Section 302 of the Act.[4] In the matter of Chicago Express, Incorporated, 332 F.2d 276, 278 (2 Cir. 1964), cert. den. 379 U.S. 879; American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A., 280 F.2d 119 (2 Cir. 1960). Manifestly, the right to priority depends upon the ability of the appellant to bring its claim within the language of the preferential classification sought. Goldie v. Cox, 130 F.2d 690 (8 Cir. 1942).

We recently expressly ruled that expenses which "are

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[3] The District Court also concluded, as did the Referee, that appellant's claim was not provable as a general claim. 242 F. Supp. at 342. On this appeal, appellant "agrees that the claim here asserted is not provable as a general claim under §63a(7) [11 U.S.C.A. §103a(7) (1953 Supp. 1964)] of the Act. . . ." Appellant's Brief, p. 20.

[4] Chapter XI.—Arrangements

"Sec. 302. The provisions of chapters I to VII, inclusive, of this Act, shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to 'bankrupts' shall be deemed to relate also to 'debtors', and 'bankruptcy proceedings' or 'proceedings in bankruptcy' shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 322 of this Act, and the date of adjudication shall be taken to be the date of the filing of the petition under section 321 or 322 of this Act except where an adjudication had previously been entered." July 1, 1898, c. 541, §302, as added June 22, 1938, c. 575, §1, 52 Stat. 905; 11 U.S.C.A. §702.

unrelated to development, preservation or distribution of the bankrupt's assets" cannot be considered "costs and expenses of administration" within the meaning of Section 64 sub.a(1) as amended in 1962. In the Matter of Connecticut Motor Lines, Inc., 336 F.2d 96 (1964).

We there said at pages 101-102:

> "Our view of the boundaries of Section 64, sub.a(1) of the Bankruptcy Act is reinforced by the latest amendment to that Section in 1962. Prior to the 1962 amendment, Section 64, sub.a(1) set forth a number of individual first priority expense items under no explicit generic label. 'Costs and expenses of administration' was one of a number of particular items enumerated in Section 64, sub.a(1). In such a posture, the Section did lend itself to a broad construction. The amendment altered the language of the Section to read as follows:
>
> "'(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) *the costs and expenses of administration, including* the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; . . . .
>
> "The impact of the amendment was to clarify the fact that Congress had considered all expenses laid out in Section 64, sub.a(1) costs and expenses of administration. The legislative history makes it clear that Congress, through the amendment, wanted to underline this factor. . . .
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> * * * * *
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> "Though those enumerated costs and expenses of administration were never meant to be all inclusive, the 1962 amendment does indicate a concern that a meaningful view be had as to what is to be considered a cost

> and expense of administration. By explicitly structuring Section 64, sub.a(1) the Congress indicated both that all items in Section 64, sub.a(1) were costs and expenses of administration, and that the expression 'costs and expenses of administration' was not a catch-all within the first priority. With such a Congressional intent apparent, it is preferable to isolate from Section 64, sub.a(1), as falling without a meaningful view of costs and expenses of administration, those expenses which, though they can be considered *post-bankruptcy items*, are unrelated to development, preservation or distribution of the bankrupt's assets."

This touchstone guide to the direction of Section 64 sub.a(1) finds support not only in the legislative history, as shown by the Court's opinion, but also in existing authority. See, American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A. *supra*, at 124-126; Saper v. John Viviane & Son, Inc., 258 F.2d 826 (2 Cir. 1958); Guerin v. Weil, Gotshal & Manges, 205 F.2d 302 (2 Cir. 1953). As these cases indicate, it is not every post-petition event giving rise to a cost, expense or liability which qualifies the cost, expense or liability for priority status under Section 64 sub.a(1).

This is the standard applied by the court below. We agree with it, and with its conclusion that appellant's tort claim does not fall within the restrictive language of Section 64 sub.a(1) as an expense so related to the development, preservation or distribution of estate assets as to be deemed to have been incurred in connection therewith. Existing judicial interpretation and application of Section 64 sub.a(1) does not indicate any other result. Indeed, it is evident that the Congress knows how to assure the priorities it desires. See, In the Matter of Hudson & Manhattan Railroad Company, 178 F. Supp. 103 (S.D.N.Y. 1959), aff'd sub nom. Augus v. Stichman, 273 F.2d 707 (2 Cir. 1960); Senate Report No. 1954, accompanying the amend-

ing legislation, H.R. 5393, 1962 U.S. Code Congressional and Administrative News, pp. 2603, 2608.

Appellant seeks an application of Section 64 sub.a(1) founded upon principles, according to the authorities it cites, utilized in equity receivership proceedings. But we find no compelling persuasion in such authorities here, where we have to deal with a purposeful statutory restriction. Cf. In the Matter of the Pusey and Jones Corporation, 295 F.2d 479 (3 Cir. 1961); In the Matter of Chicago Express, Incorporated, *supra;* American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A. *supra.*

Federal courts cannot extend the reach or sweep of a federal statute beyond its clearly defined provisions as we recently explicitly ruled in American Dredging Company v. Local 25, Marine Division, International Union of Operating Engineers, 338 F.2d 837 (1964), cert. den. 380 U.S. 935 (1965).

The purposeful statutory restriction, earlier discussed, cannot be amended by judicial legislation to accomplish the result which the minority advocates.

As we said in *American Dredging* at page 850:

> "Courts have inherent power to construe legislation and to *fashion* remedies to effectuate the legislative design but they do not have power to legislate, directly or indirectly, nor can they *amend* legislation to extend its clearly defined limits under the shelter of their power to *fashion remedies.*
>
> "The Constitution of the United States has reserved to the Congress the power to legislate. Article I, section 1 provides that 'All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives'.
>
> "Not even the Supreme Court of the United States can usurp the legislative power reserved to the Congress by the Constitution. The Supreme Court itself

has time and again paid homage to the doctrine of the separation of powers decreed by the Constitution and declared that judicial legislation is abhorrent to, and in violation of, the Constitutional scheme."

Section 64 provides that "actual and necessary expenses of preserving the estate" are entitled to a priority. The words "actual and necessary" require that the expenses be proximately related to the preservation of the estate and that they must be reasonably anticipated as a cost of operating the business. Cf. Jopek v. New York Central R.R., 353 F.2d 778 (C.A. 3, 1965). The word "necessary" in §162(a) of the Internal Revenue Code of 1954 has been similarly construed.

This construction adequately answers the question as to whether the costs of insurance would be entitled to a priority. The insurance costs which were reasonable or which were incurred in reasonable anticipation of liability within certain limits would obviously fall within §64. Those premiums, however, which were excessive—which provided for liability far in excess of that which could be reasonably anticipated—would not be entitled to a priority and, in fact, the receiver could be surcharged for their cost.

For the reasons stated, the Order of the District Court will be affirmed.

FREEDMAN, *Circuit Judge*, dissenting.

I dissent from the majority's conclusion that § 64a(1) requires the virtual immunization from tort liability of a business which is conducted by a receiver in a Chapter XI proceeding. Congress has not given us a blueprint which yields an immediate and unequivocal answer to the question and I would therefore approach it as would men of practical business experience. I believe the conclusion to which this points is in harmony with the applicable law and

accords with the equitable role of the Bankruptcy Court (§ 2 of the Bankruptcy Act. 11 U.S.C. § 11(a); see, e.g., *Bank of Marin v. England*,—U.S.—(1966); *In re Laskin*, 316 F.2d 70, 73 (3 Cir. 1963)), which applies in Chapter XI proceedings as elsewhere. See *SEC v. United States Realty & Improvement Co.*, 310 U.S. 434, 455-58 (1940).

The fundamental purpose of a Chapter XI proceeding, unlike a straight bankruptcy, is the ultimate rehabilitation of the debtor. *Nicholas v. United States*, 384 U.S. 678, 684-85 (1966); *SEC v. American Trailer Rentals Co.*, 379 U.S. 594, 603-7 (1965). The inevitable consequence of this is the continued operation of the business of the debtor and an on-going situation decisively different from the frozen rigidity of a straight bankruptcy liquidation. The reorganization court therefore applies its equitable powers to carry out this wider, business purpose.[1] Both from equitable considerations and because Congress has specifically provided that a receiver who operates the business of a debtor shall do so subject to the same requirements of law and in the same manner as if he were the debtor (28 U.S.C. § 959(b)),[2] the courts have recognized that during the pendency of a Chapter XI proceeding the receiver's operation of a business should involve the risks and liabilities which normally would flow from a business operation. Such

[1] See Matter of South Jersey Land Corp., 361 F.2d 610, 614-15 (3 Cir. 1966); Matter of Fleetwood Motel Corp., 335 F.2d 857, 862 (3 Cir. 1964), both Chapter X proceedings, which, despite their differences from Chapter XI, are fundamentally similar in looking to continuation of the business rather than liquidation. See SEC v. American Trailer Rentals Co., *supra*.

2 Section 959(b) reads:

"A trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof."

expenses therefore are entitled to payment as administrative expenses before the pre-bankruptcy claims of creditors, for whom the business is being operated as if they were stockholders. 3 *Collier on Bankruptcy* (14th ed. 1966), § 62.15, p. 1540. Thus, taxes incurred during a receivership which is established, not to wind up the business, but to foster it, have been given priority as an expense of administration. So it has been held in an equity receivership,[3] in the operation of a business in bankruptcy liquidation,[4] and in a Chapter XI proceeding.[5] These decisions have the utmost significance. They accord priority under § 64a(1) to taxes, which are not specifically listed in that section, even though the automatic accrual of such liabilities leaves no room for the rationale that priority is granted to encourage the extension of credit to the debtor.

There is no equitable reason why the claim for a tort committed by the receiver after the filing of the petition should not have the same priority which is given to a tax claim or even a contractual obligation[6] incurred after the filing of the petition. Like the operation of motor vehicles by the receiver or his employees, the shutting off of water pipes, which led to the fire, is part of an activity which may involve much profit to the estate and help to preserve the assets. It should also incur the well-known price or cost of such activities, i.e., the cost of liability insurance premiums or, absent insurance, direct responsibility for negligence as a cost and expense of preserving and manag-

[3] Michigan v. Michigan Trust Co., 286 U.S. 334 (1932), Cardozo, J., involving state corporate franchise taxes.

[4] Boteler v. Ingels, 308 U.S. 57 (1939), involving automobile license fees and penalties.

[5] Nicholas v. United States, 384 U.S. 678 (1966), where it was said that federal income taxes and interest thereon were an administrative expense.

[6] Compare In re Delaware Hosiery Mills, Inc., 202 F.2d 951 (3 Cir. 1953), and In re Arbycraft Co., 288 F.2d 553, 557 (3 Cir. 1961), where we treated claims as administration expenses under § 64a(1), although there was no express authorization in the statute.

ing the estate. The argument of the government that the risk of such liability would make suppliers unwilling to extend credit and secured creditors reluctant to accept an arrangement, ignores the ability to provide against that risk by insurance. To refuse to recognize claims resulting from the operation of the business is to create a substantial immunity from liability, ironically enough, at a time when it is being generally recognized that tort immunity has little justification. See, e.g., *United States v. Muniz*, 374 U.S. 150, 165-66 (1963). For it is clear that a tort claim based on post-petition activities cannot be proven as an ordinary claim. (See § 63 of the Bankruptcy Act, 11 U.S.C. § 103.) Today's decision, therefore, will discourage receivers and creditors of the debtor from approving expenditures for premiums for public liability insurance. It will not be much alleviated by the menace of surcharge for premiums which the majority now directs against receivers for misjudging the treacherous ground of "reasonable" insurance, or "reasonable anticipation of liability," or "excessive" premiums. Once again, it seems to me, contractual claims are unjustifiably exalted and the risks to which the public is exposed by torts which experience shows are an inevitable result of the operation of a business are treated as outcast. And what should a receiver do if in his wise judgment it is advantageous to the estate to continue to operate the business by following its former policy of acting as a self insurer rather than to begin to pay large premiums?

The trend of the decisions supports the view that the present claim is entitled to priority. Priority as an administrative expense has been accorded tort claims in straight bankruptcy cases.[7] It has been similarly granted in equity

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[7] Vass v. Conron Bros. Co., 59 F.2d 969 (2 Cir. 1932); In re Progress Lektro Shave Corp., 35 F.Supp. 915 (D.Conn. 1940); In re Michigan Motor Specialties Co., 288 Fed. 377 (E.D. Mich. 1923).

and statutory receiverships,[8] and although it is true that equity receiverships are not governed by § 64a(1), nevertheless, with respect to administration of an estate, such receiverships are fundamentally similar to Chapter XI proceedings, a similarity which the Supreme Court has recognized in determining the scope of § 64a(1). See *Nicholas v. United States*, 384 U.S. 678, 684 n. 12 (1966). There is no reason why we should not do the same.

The three cases cited by the majority in support of its refusal to apply the equity rule, *In re Pusey & Jones Corp.*, 295 F.2d 479 (3 Cir. 1961), *In re Chicago Express, Inc.*, 332 F.2d 276 (2 Cir. 1960), cert. denied, 379 U.S. 879 (1965), and *American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A.*, 280 F.2d 119 (2 Cir. 1960), differ significantly from this case. None of them involved tort claims, and in each of them the claimant admittedly was entitled to share with the general creditors. Moreover, neither *Pusey & Jones* nor *Chicago Express* involved claims of priority under § 64a(1) and both dealt with the application to Chapter XI proceedings of a special rule that had come to be applied in reorganizations of "public corporations" but was not a general doctrine of equity receiverships; indeed the conclusion in both cases was based on equitable considerations. *American Anthracite* dealt with the special problem of the assumption of existing contracts by the debtor in possession for which there was a history of special statutory provisions in bankruptcy.

The majority relies heavily on *In the Matter of Connecticut Motor Lines*, 336 F.2d 96 (3 Cir. 1964). We there held that tax expenses arising out of activities which occurred prior to the filing of the petition were properly allocable to the pre-petition period and therefore not en-

[8] E.g., Texas & Pacific Railway Co. v. Bloom's Adm'r., 164 U.S. 636, 642-43 (1897); Barton v. Barbour, 104 U.S. 126, 130 (1881); Bereth v. Sparks, 51 F.2d 441 (7 Cir. 1931) citing numerous cases; Anderson v. Condict, 93 Fed. 349, 354 (7 Cir. 1899); see also Valdes v. Feliciano, 267 F.2d 91, 95 (1 Cir. 1959).

titled to be treated as administrative expenses, but were included in § 64a(4). The opinion of the court stated that "it is preferable to isolate from Section 64, sub.a(1), as falling without a meaningful view of costs and expenses of administration, those expenses which, though they can be considered post-bankruptcy items, are unrelated to development, preservation or distribution of the bankrupt's assets." (p. 102) But that statement must be read in the light of the critical point, which the court emphasized, that priority would have been accorded the taxes if they had accrued after the filing of the petition, because in such case they would have been a "cost of protecting the fund". (p. 100) A tort claim similarly is entitled to priority; it is as much an expense of management or "development" of the estate as is a tax claim.[9]

Finding no expression in the statute to the contrary, but rather sufficient authority in its language to include the present claim, I would not recoil from doing so because it is based on a tort. I would follow the terse and specific dictum of Judge Learned Hand that "the liquidation of the lessee's resulting damages [from the trustee's negligence] was as much a part of the usual administration in bankruptcy, as that of the pay of accountants, custodians or other assistants, employed by the trustee." *Vass v. Conron Bros. Co.*, 59 F.2d 969, 971 (2 Cir. 1932).

Judges Smith and Seitz concur in this dissent.

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[9] Guerin v. Weil, Gotshal & Manges, 205 F.2d 302 (2 Cir. 1953), cited by the majority, does not govern here, and in any event, its disallowance of the expenses of petitioning creditors for the service of attorneys and accountants was overturned by Congress in 1962, Pub. L. 87-681. See S.Rep. No. 1954, 87th Cong., 2d Sess. (1962), 1962-2 U.S. Code, Cong. & Adm. News 2603, 2608.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 15,507

In the Matter of
I. J. KNIGHT REALTY CORP., *Bankrupt*

READING COMPANY, *Claimant, Appellant*

(D. C. Bankruptcy No. 27540)

On appeal from the United States District Court for the Eastern District of Pennsylvania

Present: STALEY, *Chief Judge*, and MCLAUGHLIN, KALODNER, HASTIE, SMITH, FREEDMAN and SEITZ, *Circuit Judges.*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed June 9, 1965, be, and the same is hereby affirmed.

Attest:

THOMAS F. QUINN
Clerk

January 6, 1967

Supreme Court of the United States

October Term, 1967

No. 127

READING COMPANY, *Petitioner*

v.

FRANCIS SHUNK BROWN, 3RD, etc., et al.

ORDER ALLOWING CERTIORARI

Filed October 16, 1967

The petition herein for a writ of certiorari to the United States Court of Appeals for the Third Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Marshall took no part in the consideration or decision of this petition.

CERTIFICATE OF SERVICE

STATE OF PENNSYLVANIA :
SS.
COUNTY OF PHILADELPHIA :

I, THOMAS RAEBURN WHITE, JR., counsel for the petitioner herein, and attorney of record for the petitioner in the courts below, state that on the 29th day of November, 1967, I served five copies of the foregoing Record Appendix on the respondents, as required by Rule 33, by personally mailing said copies hereof to Messrs. Dechert, Price and Rhoads, in care of their office, 1600 Three Penn Center Plaza, Philadelphia, Pennsylvania 19102 and on the United States by mailing five copies to the Solicitor General, Department of Justice, Washington 25, D. C., and to Richard M. Roberts, Assistant Attorney General, Department of Justice, Washington, D. C. 20530, the attorney who argued the brief for the United States in the courts below.

THOMAS RAEBURN WHITE, JR.
Member of the Bar of the
United States Supreme Court

1354
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IN THE

Supreme Court of the United States

FILED
MAY 4 1967
JOHN F. DAVIS, CLERK

October Term, 1966

No. ~~1354~~ 127

READING COMPANY, *Petitioner*

v.

FRANCIS SHUNK BROWN, 3RD, *Trustee of the Estate of* I. J. KNIGHT REALTY CORP., *Bankrupt, Respondent*

and

UNITED STATES OF AMERICA, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1966 No.

READING COMPANY, *Petitioner*

v.

FRANCIS SHUNK BROWN, 3RD, *Trustee of the Estate of* I. J. KNIGHT REALTY CORP., *Bankrupt, Respondent*

and

UNITED STATES OF AMERICA, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered in the above-entitled case on January 6, 1967.

CITATIONS TO OPINION BELOW

The memorandum opinion of the Referee in Bankruptcy, which is unreported, and the opinion of the District Court, reported at 242 F. Supp. 337 (E.D. Pa., 1965), are contained in the record used below, nine copies of which are filed herewith in accordance with Rule 23(i). Both the majority and dissenting opinions of the Court of Appeals, which are not yet reported, are printed in Appendix C, hereto, *infra*, pp. 11-17.

JURISDICTION

The judgment of the Court of Appeals affirming the judgment of the District Court was entered on January 6, 1967. Rehearing was denied on February 13, 1967. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

May persons whose property has been destroyed or damaged by a fire caused by the negligence of a Federal Receiver in a bankruptcy proceeding recover their damages as an expense of administration of the estate, or are they without any remedy whatever against the Receiver and the Estate he represents?

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The pertinent constitutional provision is the Due Process clause of the Fifth Amendment to the United States Constitution, U.S.C. Const. Amend. V., Appendix A, *infra*, p. 8.

The pertinent statutory provisions are Sections 2, 62(a)-(1), 63(a)(7) and 64(a)(1) of the Bankruptcy Act, 11 U.S.C. §§11, 102(a)(1), 103(a)(7) and 104(a)(1)—all printed in Appendix B, *infra*, pp. 9-11, and 28 U.S.C. §959(a) and (b), *infra*, pp. 4-5.

STATEMENT OF THE CASE

On January 1, 1963, an eight-story industrial building located at 10th and Diamond Streets, Philadelphia, Pennsylvania caught fire and burned out of control for several hours causing millions of dollars worth of damage to adjoining property owners including the Reading Company. The building was under the control of a Federal Receiver who had been appointed by a District Court judge pursuant to a voluntary Petition for Arrangement under Chapter XI of the Bankruptcy Act filed by the owner, I. J. Knight Realty Company. It is admitted for the purposes of this

appeal that the fire was caused entirely by the negligence of a night watchman employed by the Receiver. The Reading Company filed a proof of claim for its damages and asked that it be allowed as an administrative expense entitled to priority over general claims. The Referee thereafter ruled that this claim should constitute a test suit and all persons damaged as a result of the fire would be bound by the result. The Trustee in Bankruptcy filed a motion to expunge the claim entirely, not only as an expense of administration, but also as an unsecured general claim. Referee Thomas J. Curtin granted the motion and the United States District Court for the Eastern District of Pennsylvania affirmed. The Court of Appeals affirmed the decision of the District Court in a 4-3 decision. The effect of the ruling is to deprive injured property owners of any redress whatever and to render a Trustee in Bankruptcy and the fund he administers immune from the consequences of his negligence. There is of course no difference, other than procedural, between bringing of an action for damages against the Trustee under 28 U.S.C. §959 and the filing of a proof of claim as was done here. In either case the claim would be subject to proof in the Bankruptcy Court. Under the ruling of the Court below neither the claim, nor a suit based upon the claim, would have any standing whatever against the fund.

The Receiver was appointed pursuant to a petition filed under Chapter XI of the Bankruptcy Act, 11 U.S.C. §701-99. The priority of the payment of debts under that Chapter is governed by Sections 62 and 64 of the Bankruptcy Act, 11 U.S.C. §102 and §104 which give first priority to "costs and expenses of administration," among other things.

The United States of America is named as a respondent herein because it opposed petitioner below. The United States has filed a federal tax claim against the Estate which would not be paid, if petitioner's position is sustained, because of the insufficiency of the Estate.

REASONS FOR GRANTING WRIT

1. The construction of the Bankruptcy Act adopted by the Court below is violative of due process. Permitting a receiver administering a fund owned by a class of creditors to destroy the property of another tortiously, with complete immunity given to the fund, is so arbitrary and unreasonable that it violates the Due Process clause of the Fifth Amendment of the United States Constitution. This Court has held that Congress may affect property rights under the Bankruptcy Act but must not transgress the bounds of due process. *Wright v. Union Central Life Ins. Co.*, 304 U.S. 502 (1938); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935).

Petitioner's research has discovered no case in all of Anglo-American jurisprudence holding that a business being operated for the benefit of private economic interests is immune from liability for torts committed by the operator of the business. All decided cases, texts and authorities hold that, under general equity rules, torts committed by a receiver are not only provable but are invariably to be given priority status as costs and expenses of administration. See, *e.g.*, *Hale v. Frost*, 99 U.S. 389 (1878).

2. The decision of the Court of Appeals granting immunity from tort liability to a bankrupt estate completely nullifies that section of the Judicial Code (28 U.S.C. §959) which provides that trustees and receivers operating businesses are subject to suit to the same extent as private persons. That section reads as follows:

> "§959(a) Trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such

court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury.

"(b) A trustee, receiver, or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof. June 25, 1948, c. 646, 62 Stat. 926."

The right to sue a receiver, or any other tortfeasor, is obviously a nullity if the tortfeasor cannot be made to pay a judgment recovered in such a suit. Since a receiver or trustee is liable only in his representative capacity, *McNulta v. Lochridge*, 141 U.S. 327 (1891), the grant of immunity to the fund would render meaningless the right to sue granted by the above section. In that case, this Court said at 332:

"Actions against the receiver are in law actions against the receivership, or the funds in the hands of the receiver, and his contracts, malfeasances, negligences and liabilities are official and not personal, and judgments against him as receiver are payable only from the funds in his hands."

3. If the decision below prevails, receivers conducting businesses will fear to carry liability insurance sufficient to protect the public against substantial claims, much less disasters such as the fire which gave rise to this litigation. Under the holding there is no need to carry any insurance, and the dictum warns that any receiver paying "excessive" insurance premiums will be surcharged. (*infra*, appendix C, p. 17).

4. The decision is in conflict with prior decisions of this Court requiring,

(a) construction of the Bankruptcy Act in accordance wtih equity jurisprudence. *Pepper v. Litton*, 308 U.S. 295, (1939); *Securities and Exchange Commission v. U.S. Realty and Improvements Co.*, 310 U.S. 434 (1940); *Barton v. Barbour*, 104 U.S. 126 (1881); *Bank of Marin v. England*, 385 U.S. 99 (1967).

(b) payment of claims arising out of a Federal receiver's torts as priority claims. *Cowdrey v. Galveston, Houston and Henderson Ry. Co.*, 93 U.S. 352 (1876); *Hale v. Frost*, 99 U.S. 389 (1878); *McNulta v. Lochridge, supra.*

5. The decision is in conflict with the opinion of Judge Learned Hand of the Second Circuit who, in the case of *Vass v. Conron Bros. Co.*, 59 F.2d 969 (2nd Cir. 1932), stated (at p. 971) that a claim for damages arising out of the negligent operation of a business by a receiver was an expense of administration. This opinion was cited by the Judges dissenting below. Appendix C, *infra*, p. 22. The District Court for the District of Connecticut has also held that claims arising from the torts of a receiver are costs and expenses of administration in bankruptcy; In re *Progress Lektro Shave Corp.*, 35 F. Supp. 915 (D. Conn. 1940). Accordingly, the decision below has created a conflict between the Second and Third Circuits in the interpretation of the Bankruptcy Act.

6. The decision of the Court of Appeals represents a sharp departure from the accepted principles of statutory interpretation and equity jurisprudence and is in conflict with every text written on the question. See, *e.g.*, 45 Am. Jur., Receivers, §255 (1943); 45 Am. Jur., Receivers, §349 (1943); 75 C.J.S., Receivers §293(h) (1952); Clark, Receivers, §396(h) (3rd Ed. 1959); Clark, Receivers, §640.9 (3rd Ed. 1959); Collier on Bankruptcy §62.01 (14th Ed. 1964); Collier on Bankruptcy §62.03 (14th Ed. 1964); Collier on Bankruptcy §62.15 (14th Ed. 1964); Collier on Bankruptcy §64.01 (14th Ed. 1964).

CONCLUSION

For the foregoing reasons, this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

By

THOMAS RAEBURN WHITE, JR.
WHITE AND WILLIAMS
Attorneys for Petitioner

CERTIFICATE OF SERVICE

STATE OF PENNSYLVANIA
COUNTY OF PHILADELPHIA ss.

I, THOMAS RAEBURN WHITE, JR., counsel for the petitioner herein, and attorney of record for the petitioners in the courts below, state that on the 2nd day of May, 1967, I served two copies of the foregoing Petition for Writ of Certiorari on the respondents, as required by Rule 33, Paragraph 1, by personally mailing said copies hereof to Messrs. Dechert, Price and Rhoads, in care of their office, 1600 Three Penn Center Plaza, Philadelphia, Pennsylvania 19102 and on the United States by mailing two copies to the Solicitor General, Department of Justice, Washington 25, D. C., and to Richard M. Roberts, Assistant Attorney General, Department of Justice, Washington, D. C. 20530, the attorney who argued the brief for the United States in the courts below.

THOMAS RAEBURN WHITE, JR.
Member of the Bar of the
United States Supreme Court

APPENDIX A

Amendment V — Capital Crimes; Double Jeopardy; Self-Incrimination; Due Process; Just Compensation for Property

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

APPENDIX B

11 U.S.C. §11 (Bankruptcy Act §2)

§11. *Creation of courts of bankruptcy and their jurisdiction.*

(a) The courts of the United States hereinbefore defined as courts of bankruptcy are created courts of bankruptcy and are invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * * * *

(2) Allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates;

* * * * * *

11 U.S.C. §102(a)(1) (Bankruptcy Act §62)

§102. *Expenses of administering estates; unauthorized sharing of fees; withholding allowances.*

(a) (1) The actual and necessary costs and expenses incurred by officers, other than refrees, in the administration of estates shall, except where other provision are made for their payment, be reported in detail under oath, and examined and approved or disapproved by the court. If approved, they shall be paid or allowed out of the estates in which they were incurred.

* * * * * *

11 U.S.C. §103(a)(7) (Bankruptcy Act §63(a)(7))

§103. *Debts which may be proved.*

(a) Debts of the bankrupt may be proved and allowed against his estate which are founded upon . . .

(7) the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy; . . .

* * * * * *

11 U.S.C. §104a)(1) (Bankruptcy Act §64(a)(1))

§104. *Debts which have priority.*

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; . . .

* * * * *

APPENDIX C

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 15507

In the Matter of:

I. J. KNIGHT REALTY CORP., BANKRUPT

READING COMPANY

Appellant

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued May 5, 1966

Reargued December 8, 1966

Before STALEY, *Chief Judge* and MCLAUGHLIN, KALODNER, HASTIE, SMITH, FREEDMAN and SEITZ, *Circuit Judges*

Opinion of the Court

(Filed January 6, 1967)

By KALODNER, *Circuit Judge*

The issue presented on this appeal is whether appellant's claim, if proved, is entitled to the priority status

accorded to costs of administration by Section 64, sub.a(1) of the Bankruptcy Act.[1]

The facts are not in dispute, and have been stipulated. In substance, they are as follows:

On November 16, 1962, I. J. Knight Realty Corp. filed a petition for arrangement under Chapter XI of the Bankruptcy Act. On the same day, the District Court appointed a Receiver and authorized him to operate the debtor's business, which consisted principally in the leasing of the debtor's eight-story industrial building in Philadelphia. On January 1, 1963, this building was destroyed by a fire which spread to adjoining premises and caused damage to real and personal property of The Reading Company, appellant herein, and of others.

On April 3, 1963, appellant filed a claim for damages in the amount of $559,730.83, alleging that the receiver was negligent in permitting the fire to start and "to spread far beyond its normal confines." The claim specifically recited that it was "for administrative expenses due to the negligence of the Receiver in operation of business of the debtor." Other claimants have filed 146 additional claims, similarly grounded and similarly seeking priority status as administration expenses, totalling in excess of $3,500,000. Those claims are held in abeyance by the Referee pending the ultimate disposition of the claim now on appeal.

---

[1] "Sec. 64. Debts which have priority.

"a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; . . . Where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superceded proceeding and in the suspended bankruptcy proceeding, if any; . . ." Bankruptcy Act, §64 sub.a(1), 11 U.S.C.A. §104, sub.a(1), Sept. 25, 1962, 76 Stat. 571.

On May 14, 1963, the debtor was voluntarily adjudicated a bankrupt. A Trustee was elected, and he moved to expunge appellant's claim on the ground that it was not an administration expense under Section 64, sub.a(1) of the Bankruptcy Act.[2] The Referee expunged the claim. On petition for review, the District Court concluded that the claim was not entitled to priority as an administration expense under Section 64, sub.a(1).[3] 242 F. Supp. 337 (E.D. Pa. 1965).

We are of the opinion that the Order of the District Court should be affirmed.

The right of a claim to priority status in a Chapter XI proceeding is controlled exclusively by Section 64 of the Bankruptcy Act by virtue of the provisions of Section 302 of the Act.[4] *In the matter of Chicago Express, Incorpo-*

---

[2] The stipulation of the parties, entitled "Case Stated", is set out at 242 F. Supp. at 338-339. It appears therefrom that the Trustee will have for distribution between $630,000 and $845,000, depending on the outcome of pending litigation against fire insurance companies. The status of the instant claim becomes important particularly to the United States, which has a substantial priority claim under Section 64, sub.a(4).

[3] The District Court also concluded, as did the Referee, that appellant's claim was not provable as a general claim. 242 F. Supp. at 342. On this appeal, appellant "agrees that the claim here asserted is not provable as a general claim under §63a(7) [11 U.S.C.A. §103a(7) (1953 Supp. 1964)] of the Act. . . ." Appellant's Brief, p. 20.

[4] Chapter XI—Arrangements

"Sec. 302. The provisions of chapters I to VII, inclusive, of this Act, shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to 'bankrupts' shall be deemed to relate also to 'debtors', and 'bankruptcy proceedings' or 'proceedings in bankruptcy' shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 322 of this Act, and the date of adjudication shall be taken to be the date of the filing of the petition under section 321 or 322 of this Act except where an adjudication had previously been entered." July 1, 1898, c. 541, §302, as added June 22, 1938, c. 575, §1; 52 Stat. 905; 11 U.S.C.A. §702.

rated, 332 F.2d 276, 278 (2 Cir. 1964), cert. den. 379 U.S. 879; American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A., 280 F.2d 119 (2 Cir. 1960). Manifestly, the right to priority depends upon the ability of the appellant to bring its claim within the language of the preferential classification sought. Goldie v. Cox, 130 F.2d 690 (8 Cir. 1942).

We recently expressly ruled that expenses which "are unrelated to development, preservation or distribution of the bankrupt's assets" cannot be considered "costs and expenses of administration" within the meaning of Section 64 sub.a(1) as amended in 1962. In the Matter of Connecticut Motor Lines, Inc., 336 F.2d 96 (1964).

We there said at pages 101-102:

> "Our view of the boundaries of Section 64, sub.a(1) of the Bankruptcy Act is reinforced by the latest amendment to that Section in 1962. Prior to the 1962 amendment, Section 64, sub.a(1) set forth a number of individual first priority expense items under no explicit generic label. 'Costs and expenses of administration' was one of a number of particular items enumerated in Section 64, sub.a(1). In such a posture, the Section did lend itself to a broad construction. The amendment altered the language of the Section to read as follows:
>
> "'(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) *the costs and expenses of administration, including* the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; . . . .
>
> "The impact of the amendment was to clarify the fact that Congress had considered all expenses laid out in Section 64, sub.a(1) costs and expenses of administration. The legislative history makes it clear that Con-

gress, through the amendment, wanted to underline this factor. . . .

* * * * *

"Though those enumerated costs and expenses of administration were never meant to be all inclusive, the 1962 amendment does indicate a concern that a meaningful view be had as to what is to be considered a cost and expense of administration. By explicitly structuring Section 64, sub.a(1) the Congress indicated both that all items in Section 64, sub.a(1) were costs and expenses of administration, and that the expression 'costs and expenses of administration' was not a catch-all within the first priority. With such a Congressional intent apparent, it is preferable to isolate from Section 64, sub.a(1), as falling without a meaningful view of costs and expenses of administration, those expenses which, though they can be considered *post-bankruptcy items*, are unrelated to development, preservation or distribution of the bankrupt's assets."

This touchstone guide to the direction of Section 64 sub.a(1) finds support not only in the legislative history, as shown by the Court's opinion, but also in existing authority. See, American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A. *supra*, at 124-126; Saper v. John Viviane & Son, Inc., 258 F.2d 826 (2 Cir. 1958); Guerin v. Weil, Gotshal & Manges, 205 F.2d 302 (2 Cir. 1953). As these cases indicate, it is not every post-petition event giving rise to a cost, expense or liability which qualifies the cost, expense or liability for priority status under Section 64 sub.a(1).

This is the standard applied by the court below. We agree with it, and with its conclusion that appellant's tort claim does not fall within the restrictive language of Section 64 sub.a(1) as an expense so related to the development, preservation or distribution of estate assets as to be deemed to have been incurred in connection therewith.

Existing judicial interpretation and application of Section 64 sub.a(1) does not indicate any other result. Indeed, it is evident that the Congress knows how to assure the priorities it desires. See, In the Matter of Hudson & Manhattan Railroad Company, 178 F. Supp. 103 (S.D.N.Y. 1959), aff'd sub nom. Augus v. Stichman, 273 F.2d 707 (2 Cir. 1960); Senate Report No. 1954, accompanying the amending legislation, H.R. 5393, 1962 U.S. Code Congressional and Administrative News, pp. 2603, 2608.

Appellant seeks an application of Section 64 sub.a(1) founded upon principles, according to the authorities it cites, utilized in equity receivership proceedings. But we find no compelling persuasion in such authorities here, where we have to deal with a purposeful statutory restriction. Cf. In the Matter of the Pusey and Jones Corporation, 295 F.2d 479 (3 Cir. 1961); In the Matter of Chicago Express, Incorporated, *supra;* American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A. *supra.*

Federal courts cannot extend the reach or sweep of a federal statute beyond its clearly defined provisions as we recently explicitly ruled in American Dredging Company v. Local 25, Marine Division, International Union of Operating Engineers, 338 F.2d 837 (1964), cert. den. 380 U.S. 935 (1965).

The purposeful statutory restriction, earlier discussed, cannot be amended by judicial legislation to accomplish the result which the minority advocates.

As we said in *American Dredging* at page 850:

> "Courts have inherent power to construe legislation and to *fashion* remedies to effectuate the legislative design but they do not have power to legislate, directly or indirectly, nor can they *amend* legislation to extend its clearly defined limits under the shelter of their power to *fashion remedies.*
>
> "The Constitution of the United States has reserved to the Congress the power to legislate. Article I, section 1 provides that 'All legislative Powers herein granted

> shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives'.
>
> "Not even the Supreme Court of the United States can usurp the legislative power reserved to the Congress by the Constitution. The Supreme Court itself has time and again paid homage to the doctrine of the separation of powers decreed by the Constitution and declared that judicial legislation is abhorrent to, and in violation of, the Constitutional scheme."

Section 64 provides that "actual and necessary expenses of preserving the estate" are entitled to a priority. The words "actual and necessary" require that the expenses be proximately related to the preservation of the estate and that they must be reasonably anticipated as a cost of operating the business. Cf. Jopek v. New York Central R.R., 353 F.2d 778 (C.A. 3, 1965). The word "necessary" in §162(a) of the Internal Revenue Code of 1954 has been similarly construed.

This construction adequately answers the question as to whether the costs of insurance would be entitled to a priority. The insurance costs which were reasonable or which were incurred in reasonable anticipation of liability within certain limits would obviously fall within §64. Those premiums, however, which were excessive—which provided for liability far in excess of that which could be reasonably anticipated—would not be entitled to a priority and, in fact, the receiver could be surcharged for their cost.

For the reasons stated, the Order of the District Court will be affirmed.

FREEDMAN, *Circuit Judge*, dissenting.

I dissent from the majority's conclusion that §64a(1) requires the virtual immunization from tort liability of a business which is conducted by a receiver in a Chapter XI

proceeding. Congress has not given us a blueprint which yields an immediate and unequivocal answer to the question and I would therefore approach it as would men of practical business experience. I believe the conclusion to which this points is in harmony with the applicable law and accords with the equitable role of the Bankruptcy Court (§ 2 of the Bankruptcy Act. 11 U.S.C. § 11(a); see, e.g., *Bank of Marin v. England*,—U.S.—(1966); *In re Laskin*, 316 F.2d 70, 73 (3 Cir. 1963)), which applies in Chapter XI proceedings as elsewhere. See *SEC v. United States Realty & Improvement Co.*, 310 U.S. 434, 455-58 (1940).

The fundamental purpose of a Chapter XI proceeding, unlike a straight bankruptcy, is the ultimate rehabilitation of the debtor. *Nicholas v. United States*, 384 U.S. 678, 684-85 (1966); *SEC v. American Trailer Rentals Co.*, 379 U.S. 594, 603-7 (1965). The inevitable consequence of this is the continued operation of the business of the debtor and an on-going situation decisively different from the frozen rigidity of a straight bankruptcy liquidation. The reorganization court therefore applies its equitable powers to carry out this wider, business purpose.[1] Both from equitable considerations and because Congress has specifically provided that a receiver who operates the business of a debtor shall do so subject to the same requirements of law and in the same manner as if he were the debtor (28 U.S.C. § 959(b)),[2] the courts have recognized that during the

[1] See Matter of South Jersey Land Corp., 361 F.2d 610, 614-15 (3 Cir. 1966); Matter of Fleetwood Motel Corp., 335 F.2d 857, 862 (3 Cir. 1964), both Chapter X proceedings, which, despite their differences from Chapter XI, are fundamentally similar in looking to continuation of the business rather than liquidation. See SEC v. American Trailer Rentals Co., *supra*.

2 Section 959(b) reads:

"A trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof."

pendency of a Chapter XI proceeding the receiver's operation of a business should involve the risks and liabilities which normally would flow from a business operation. Such expenses therefore are entitled to payment as administrative expenses before the pre-bankruptcy claims of creditors, for whom the business is being operated as if they were stockholders. 3 *Collier on Bankruptcy* (14th ed. 1966), § 62.15, p. 1540. Thus, taxes incurred during a receivership which is established, not to wind up the business, but to foster it, have been given priority as an expense of administration. So it has been held in an equity receivership,[3] in the operation of a business in bankruptcy liquidation,[4] and in a Chapter XI proceeding.[5] These decisions have the utmost significance. They accord priority under § 64a(1) to taxes, which are not specifically listed in that section, even though the automatic accrual of such liabilities leaves no room for the rationale that priority is granted to encourage the extension of credit to the debtor.

There is no equitable reason why the claim for a tort committed by the receiver after the filing of the petition should not have the same priority which is given to a tax claim or even a contractual obligation[6] incurred after the filing of the petition. Like the operation of motor vehicles by the receiver or his employees, the shutting off of water pipes, which led to the fire, is part of an activity which may involve much profit to the estate and help to preserve the assets. It should also incur the well-known price or

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[3] Michigan v. Michigan Trust Co., 286 U.S. 334 (1932), Cardozo, J., involving state corporate franchise taxes.

[4] Boteler v. Ingels, 308 U.S. 57 (1939), involving automobile license fees and penalties.

[5] Nicholas v. United States, 384 U.S. 678 (1966), where it was said that federal income taxes and interest thereon were an administrative expense.

[6] Compare In re Delaware Hosiery Mills, Inc., 202 F.2d 951 (3 Cir. 1953), and In re Arbycraft Co., 288 F.2d 553, 557 (3 Cir. 1961), where we treated claims as administration expenses under § 64a(1), although there was no express authorization in the statute.

cost of such activities, i.e., the cost of liability insurance premiums or, absent insurance, direct responsibility for negligence as a cost and expense of preserving and managing the estate. The argument of the government that the risk of such liability would make suppliers unwilling to extend credit and secured creditors reluctant to accept an arrangement, ignores the ability to provide against that risk by insurance. To refuse to recognize claims resulting from the operation of the business is to create a substantial immunity from liability, ironically enough, at a time when it is being generally recognized that tort immunity has little justification. See, e.g., *United States v. Muniz*, 374 U.S. 150, 165-66 (1963). For it is clear that a tort claim based on post-petition activities cannot be proven as an ordinary claim. (See § 63 of the Bankruptcy Act, 11 U.S.C. § 103.) Today's decision, therefore, will discourage receivers and creditors of the debtor from approving expenditures for premiums for public liability insurance. It will not be much alleviated by the menace of surcharge for premiums which the majority now directs against receivers for misjudging the treacherous ground of "reasonable" insurance, or "reasonable anticipation of liability," or "excessive" premiums. Once again, it seems to me, contractual claims are unjustifiably exalted and the risks to which the public is exposed by torts which experience shows are an inevitable result of the operation of a business are treated as outcast. And what should a receiver do if in his wise judgment it is advantageous to the estate to continue to operate the business by following its former policy of acting as a self insurer rather than to begin to pay large premiums?

The trend of the decisions supports the view that the present claim is entitled to priority. Priority as an administrative expense has been accorded tort claims in straight bankruptcy cases.[7] It has been similarly granted in equity

[7] Vass v. Conron Bros. Co., 59 F.2d 969 (2 Cir. 1932); In re Progress Lektro Shave Corp., 35 F.Supp. 915 (D.Conn. 1940); In re Michigan Motor Specialties Co., 288 Fed. 377 (E.D. Mich. 1923).

and statutory receiverships,[8] and although it is true that equity receiverships are not governed by § 64a(1), nevertheless, with respect to administration of an estate, such receiverships are fundamentally similar to Chapter XI proceedings, a similarity which the Supreme Court has recognized in determining the scope of § 64a(1). See *Nicholas v. United States*, 384 U.S. 678, 684 n. 12 (1966). There is no reason why we should not do the same.

The three cases cited by the majority in support of its refusal to apply the equity rule, *In re Pusey & Jones Corp.*, 295 F.2d 479 (3 Cir. 1961), *In re Chicago Express, Inc.*, 332 F.2d 276 (2 Cir. 1960), cert. denied, 379 U.S. 879 (1965), and *American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A.*, 280 F.2d 119 (2 Cir. 1960), differ significantly from this case. None of them involved tort claims, and in each of them the claimant admittedly was entitled to share with the general creditors. Moreover, neither *Pusey & Jones* nor *Chicago Express* involved claims of priority under § 64a(1) and both dealt with the application to Chapter XI proceedings of a special rule that had come to be applied in reorganizations of "public corporations" but was not a general doctrine of equity receiverships; indeed the conclusion in both cases was based on equitable considerations. *American Anthracite* dealt with the special problem of the assumption of existing contracts by the debtor in possession for which there was a history of special statutory provisions in bankruptcy.

The majority relies heavily on *In the Matter of Connecticut Motor Lines*, 336 F.2d 96 (3 Cir. 1964). We there held that tax expenses arising out of activities which occurred prior to the filing of the petition were properly allocable to the pre-petition period and therefore not en-

[8] E.g., Texas & Pacific Railway Co. v. Bloom's Adm'r., 164 U.S. 636, 642-43 (1897); Barton v. Barbour, 104 U.S. 126, 130 (1881); Bereth v. Sparks, 51 F.2d 441 (7 Cir. 1931) citing numerous cases; Anderson v. Condict, 93 Fed. 349, 354 (7 Cir. 1899); see also Valdes v. Feliciano, 267 F.2d 91, 95 (1 Cir. 1959).

titled to be treated as administrative expenses, but were included in § 64a(4). The opinion of the court stated that "it is preferable to isolate from Section 64, sub.a(1), as falling without a meaningful view of costs and expenses of administration, those expenses which, though they can be considered post-bankruptcy items, are unrelated to development, preservation or distribution of the bankrupt's assets." (p. 102) But that statement must be read in the light of the critical point, which the court emphasized, that priority would have been accorded the taxes if they had accrued after the filing of the petition, because in such case they would have been a "cost of protecting the fund". (p. 100) A tort claim similarly is entitled to priority; it is as much an expense of management or "development" of the estate as is a tax claim.[9]

Finding no expression in the statute to the contrary, but rather sufficient authority in its language to include the present claim, I would not recoil from doing so because it is based on a tort. I would follow the terse and specific dictum of Judge Learned Hand that "the liquidation of the lessee's resulting damages [from the trustee's negligence] was as much a part of the usual administration in bankruptcy, as that of the pay of accountants, custodians or other assistants, employed by the trustee." *Vass v. Conron Bros. Co.*, 59 F.2d 969, 971 (2 Cir. 1932).

Judges Smith and Seitz concur in this dissent.

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[9] Guerin v. Weil, Gotshal & Manges, 205 F.2d 302 (2 Cir. 1953), cited by the majority, does not govern here, and in any event, its disallowance of the expenses of petitioning creditors for the service of attorneys and accountants was overturned by Congress in 1962, Pub. L. 87-681. See S.Rep. No. 1954, 87th Cong., 2d Sess. (1962), 1962-2 U.S. Code, Cong. & Adm. News 2603, 2608.

JUN 2 1967
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

October Term, 1966

No. 1354

READING COMPANY,

Petitioner

v.

FRANCIS SHUNK BROWN, 3RD, Trustee of the Estate of I. J. KNIGHT REALTY CORP., Bankrupt,

Respondent,

and

UNITED STATES OF AMERICA,

Respondent.

BRIEF OF RESPONDENT FRANCIS SHUNK BROWN, 3RD, TRUSTEE OF THE ESTATE OF I. J. KNIGHT REALTY CORP., BANKRUPT, IN OPPOSITION TO PETITION FOR CERTIORARI.

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OPINIONS BELOW.

The opinion of the Referee in Bankruptcy is not reported, but is printed in the record at 22a et seq. The opinion of the District Court, with its appendix (35a) is reported at 242 F. Supp. 337. The majority and dissenting opinions of the Court of Appeals for the Third Circuit are printed in petitioner's Appendix C, pp. 11-22, and have now been reported at 370 F. 2d 624.

JURISDICTION.

The judgment of the Court of Appeals was entered on January 6, 1967. An order of the Court of Appeals denying petitioner's petition for rehearing was entered on February 13, 1967. Petitioner seeks to invoke the jurisdiction of this court under 62 Stat. 928, c. 646, 28 U. S. C. § 1254(1).

QUESTION PRESENTED.

Is an unliquidated negligence claim against a receiver which arises during a Chapter XI proceeding entitled to a first priority as an "actual and necessary cost [or expense of administration]" as that term is used in Sections 62a(1) and 64a(1) of the Bankruptcy Act?

STATUTES INVOLVED.

The pertinent statutory provisions are Sections 62a(1), 63a(7), 64a and 77n of the Bankruptcy Act; 11 U. S. C. § 102(a)(1), § 103(a)(7), § 104(a) and § 205(n) respectively. All of said sections except § 77n (and § 64a, only a portion of which was printed) have been printed at pages 9 and 10 of the petition. Sections 64a and 77n are printed in full in respondent's Appendix, *infra,* at pp. A1 to A3.

This respondent contends that there are no constitutional issues present here, and hence, no constitutional provisions involved.

STATEMENT OF THE CASE.

On November 16, 1962, I. J. Knight Realty Corporation filed a petition in the District Court for the Eastern District of Pennsylvania for an arrangement under Chapter XI of the Bankruptcy Act. Francis Shunk Brown, 3rd, Esquire was appointed receiver to operate the business of the debtor, whose principal asset was an 8-story industrial structure known as the Fretz Building, located at 10th and Diamond Streets in Philadelphia.

On January 1, 1963, a fire of unusual intensity, fanned by winds of exceptionally high velocity completely destroyed the Fretz Building. It was a twelve-alarm fire, and the biggest in the history of Philadelphia (6a). The fire also damaged or destroyed adjoining property, including property of the Reading Company.

Thereafter, the Reading Company filed a claim in the bankruptcy proceeding styled a claim for "administration expenses due to the negligence of the Receiver in operation of the business of the debtor." On May 14, 1963, the corporation was adjudicated a bankrupt pursuant to a voluntary consent to adjudication. The receiver was elected trustee, and as such filed a petition to expunge the Reading Company's claim as not being a "cost of expense of administration" as that term is used in the Bankruptcy Act. The trustee and the Reading Company submitted the issues presented by the trustee's petition on the basis of a case-stated (20a).

Referee Thomas J. Curtin granted the prayer of the trustee's petition in an opinion and order which holds that the Reading Company's claim does not qualify as a cost or expense of administration under Section 64a(1) and is not provable as an unsecured claim under Section 63 of the Act (22a). In an opinion and order dated June 9, 1965,

the Honorable Francis L. Van Dusen of the District Court for the Eastern District of Pennsylvania, affirmed Referee Curtin's order (35a). Subsequently a majority of the United States Court of Appeals for the Third Circuit, per Judge Kalodner, affirmed Judge Van Dusen's order (Petitioner's Appendix C, p. 11; 370 F. 2d 624).

ARGUMENT.

This is not a case in which the Court below is establishing a general rule foreclosing large groups of victims from recovery of tort damages. This is a case in which the priorities established by Congress in the Bankruptcy Act have been applied. Priorities alone are involved here, and not substantive rights. The struggle is between the qualified creditors of the bankrupt on the one hand, and on the other, the railroad company, and, presumably, the companies which took the risk of insuring adjacent property owners from loss by fire. These parties have a remedy under 28 U. S. C. § 959, in a plenary action. Their claims are not discharged in the bankruptcy proceeding. As the court below intimated, the receiver appointed to operate a business under Chapter XI, like any other prudent business man, takes out public liability insurance.

Surely at other times and places torts have been committed by bankrupts to or against property contiguous to theirs, or to persons in the vicinity of or on a bankrupt's property, or by vehicles belonging to bankrupts. No case, however, has been found in which a contention similar to that of the present petitioner has been made. The reason for the absence of cases may be that the liability insurance proceeds were adequate to pay losses incurred. In the present situation the fire was of woefully unique proportions, and no reasonably foreseeable insurance coverage could possibly have been adequate or even carried.

Although Congress has on a number of occasions considered and amended the Bankruptcy Act, it has never chosen to amend Section 63a(7), the only section dealing with provable tort claims other than Section 77n. The latter was added by amendment to deal with injuries and death of railroad employees, which first were recognized by Congress in an earlier amendment in 1933 (38a, footnote 2). Under the provisions of Section 63a(7), tort claims to be

provable must have been instituted "prior to" and be "pending at the time of the filing of the petition in bankruptcy . . ."

A. This Case Establishes No New or Unusual Principle.

This case is unusual because the holocaust wiped out the bankrupt's business, which in turn resulted in the creation of a fund. Were it not for such fund, this litigation would never have been instituted. The existence of a fund doesn't authorize the courts to alter statutory priorities governing distribution as established by Congress. Where Congress, by statute, has provided how a fund is to be distributed (See Section 64a, Appendix p. A1), courts should not, under the guise of applying equitable principles, set aside, ignore or modify the statutory mandates. Under the provisions of Section 63a, negligence claims cannot be proved unless they are instituted prior to, and are pending at the time of the petition in bankruptcy. Contrary to such a provision, petitioner is asking this Court not only to permit such a claim which arose subsequent to the filing of the petition to be proved, but also to be granted priority ahead of all other claims, of whatsoever nature, general or preferred.

B. The Decision Below Was Correct.

Congress, in enacting and amending the bankruptcy laws, has spoken twice on the proof and allowance of tort claims (Sections 63a(7) and 77n). In bankruptcy, tort claims to be provable, must have been pending when the petition was filed. Even when tort claims are properly pending and therefore provable, they are granted no priority (p. A1; petition, p. 10). In railroad receiverships, claims for deceased or injured employees are paid as operating expenses (Section 77n, p. A3). The Court below concluded (Appendix C to petition, p. 16) that this congressional design disclosed an intention not to include any other tort claims arising during the receivership, and

specifically, not to permit them a priority status under Section 64a(1) as a cost or expense of administration. In a case discussing Section 67(c) in its relationship to Section 64a(1) and (2), this Court, in *Goggin v. California Labor Division*, 336 U. S. 118 (1949), at p. 127, alluded to the narrowness of the priority of administrative expenses and wage claims.

As this Court said in *U. S. v. Embassy Restaurant, Inc.*, 359 U. S. 29, 31 (1959), ". . . [I]f one claimant is to be preferred over others, the purpose should be clear from the statute.' At page 35, this Court said "Under the Bankruptcy Act . . . not all claims 'justly due' have priority. They must be within a class such as 'wages . . . due to workmen.' The claims here are not. If this class is to be so enlarged, it must be done by the Congress."

C. The Reasons Advanced by the Petitioner for the Grant of Certiorari Are Without Merit.

The reasons advanced by the petitioner in support of its petition are dealt with in the following correspondingly numbered paragraphs:

1. *There Is No Constitutional Issue.*

There has been no denial of due process here, and the cases cited to the contrary are not germane. The object of the bankruptcy statutes is the equitable distribution of the debtor's assets among his creditors. Congress, in determining what such an equitable distribution demands, is free to establish standards of proof and measures of allowance regardless of the claimant's ability to maintain an action in a court or the measure of his recovery in such an action if maintainable. *Kuehner v. Irving Trust Co.*, 299 U. S. 445, 451 (1937). The size of the holocaust may lend the present case a certain dramatic impact, but this circustance does not call for the invocation of constitutional rights.

2. *The Decision Below Is Not at Variance With § 959 of the Judicial Code.*

The assertion that Section 959 of the Judicial Code (28 U. S. C. § 959) is nullified is without merit. This Section is an administrative one, lumped together with various others having to do with the duties and responsibilities of court clerks, expenses of running their offices, etc. The fact that it codifies the right to sue a trustee does not automatically carry with it the further requirement that any judgment so recovered be collectible. Many judgment creditors are unable to collect their judgments, but it has never yet been held that this circumstance rendered inoperative the statute under which they brought suit. Petitioner has been deprived of no remedy or redress. He has merely been denied the right to participate in the distribution of the assets in the bankrupt estate. His claim has not been discharged by bankruptcy. He can still pursue the debtor after the administration of the estate has been completed.

3. *The Decision Below Will Not Affect Prudent Administration by Receivers.*

The argument that receivers will fear to carry liability insurance because of the opinion below is without merit. Under no circumstances would anyone, whether he were the receiver, or the owner of a going concern, who was operating a building like the one involved here, take out liability insurance sufficient to cover the losses which ultimately resulted in this case. The court below recognized this and intimated correctly that this was a liability which could not reasonably be anticipated. Of course reasonable insurance precautions will continue to be taken in the future as they have in the past, under the guidance of the Bankruptcy Court, if necessary.

As in the past, the insurance taken out by the receiver will be sufficient to protect against the cornice falling off or the faulty sidewalk. The everyday practices of receivers in this respect, their rights and liabilities, and those of the

people with whom they deal, will in no wise be affected by the outcome of this case; and it is safe to say that any rule which might be fashioned by this Court at the behest of the petitioner will have applicability to this case and this case alone.

4. *There Is No Conflict With Prior Decisions of This Court.*

(a) For petitioner to say that the Bankruptcy Act should be construed in accordance with equity jurisprudence is to say that this Court should substitute petitioner's notion of equity for that which Congress has enacted. If the property damage claimants were to be granted the priority they seek, all other claims, priority and otherwise, would be extinguished many times over, and their claims would be discharged. The cases cited by petitioner do not support its contention.

(b) In support of petitioner's contention that this Court has held that claims for receiver's torts are priority claims, petitioner cites the old railroad cases. At the risk of repetition, it must again be said that these illustrate that when Congress wishes to favor a type of tort claimant, it knows how to do so, and will not leave the matter to the hazards of development through case law.

Other than the torts dealt with in Section 63a (Petition, p. 10), only one class of tort claimant has had the treatment accorded it which the petitioner is urging here, and that is the class described in Section 77n (p. A3), namely injured railroad employees, and personal representatives of deceased railroad employees. If Congress had desired to extend this priority to other tort claimants, it would certainly have done so.

5. *There Is No Conflict of Decision Between Circuits.*

As the District Court pointed out in its opinion (42a), there are no cases which have directly considered the pres-

ent issue. The reasons for this have already been alluded to. The present factual situation is unique and likely to remain so. Therefore, contrary to petitioner's assertion, its case is not in conflict with the Second Circuit case cited, *Vass v. Conron Bros.*, 59 F. 2d 969 (2d Cir. 1932). That case simply held that the bankruptcy court was the proper forum to determine a lessee's claim for damages against the trustee arising from the trustee's operation of the premises. Both the referee and the district judge found the portions of that opinion relied upon by petitioner to be dictum (26a, 47a). Apart from the fact that *In re Progress Lektro Shave Corp.*, 35 F. Supp. 915 (D. Conn. 1940) is not a Court of Appeals case, it is clearly distinguishable from the present one, and therefore creates no conflict. As the district judge pointed out (46a), that case involved a trustee selling for the benefit of the bankrupt estate an article covered by the claimant's patent. To have denied the claimant recovery would have been to deny him the right to his own property and have permitted unjust enrichment to the bankrupt estate. There is no such element in the case at bar.

Not only is there no conflict among circuits, but rulings in analogous cases, even though not strictly on point, disclose that generally, where Section 64a has been considered, the courts have refrained from using it as a catch-all for post-bankruptcy items at the behest of aggrieved claimants. An example of such a case is *In re Connecticut Motor Lines, Inc.*, 336 F. 2d 96 (3d Cir. 1964), discussed and quoted at length by the Referee (27a et seq.), the District Court (40a), and the Court below (petition, pp. 14, 15). Briefly stated, there is no holding among the Courts of Appeals which would lend color to a contrary argument.

6. *There Is No Departure From the Accepted Principles of Statutory Interpretation or of Equity Jurisprudence, Nor Variance From the Views of the Text Writers.*

Statutory interpretation has been dealt with above under other headings. The Referee and the Courts below have construed the Bankruptcy Act consistently with the intention of Congress. Petitioner has cited texts having to do with equity receiverships, but these are not authority for bankruptcy administration, and the bankruptcy acts have never been regarded as a codification of existing equity practice. The most that can be gleaned from the cited works of Collier on the present problem is that costs and expenses will be carefully examined to see that they have been for the purpose of aiding the administration of the estate or enhancing its value before they will be recognized as deserving to be included within the priority here discussed.

CONCLUSION.

For the reasons stated it is respectfully submitted that this petition for a writ of certiorari should be denied.

Respectfully submitted,

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June 2, 1967.

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APPENDIX.

11 U. S. C. § 104 (Bankruptcy Act § 64a).

§ 64. *Debts Which Have Priority.* a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of title 18 of the United States Code, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a

proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under Chapter 9 of Title 18 of the United States Code, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy: *Provided, however,* That no priority over general unsecured claims shall pertain to taxes not included in the foregoing priority: *And provided further,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined

by the court; and (5) debts other than for taxes owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law or who is entitled to priority by paragraph (2) of subdivision c. of Section 67 of this Act: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

11 U. S. C. 205(n) (Bankruptcy Act § 77n).

(n) In proceedings under this section, and in equity receiverships of railroad corporations now or hereafter pending in any court of the United States, claims for personal injuries to employees of a railroad corporation, claims of personal representatives of deceased employees of a railroad corporation, arising under State or Federal laws, and claims now or hereafter payable by sureties upon supersedeas, appeal, attachment, or garnishment bonds, executed by sureties without security, for and in any action brought against such railroad corporation or trustees appointed pursuant to this section, shall be preferred and paid out of the assets of such railroad corporation as operating expenses of such railroad. No judge or trustee acting under this Act shall change the wages or working conditions of railroad employees except in the manner prescribed in the Railway Labor Act, as amended June 21, 1934, or as it may be hereafter amended. No reorganization effected under this Act and no order of the court or Commission in connection therewith shall relieve any carrier from the obligation of any final judgment of any Federal or State court rendered prior to January 1, 1929, against such carrier or against one of its predecessors in title, requiring the maintenance of offices, shops, and roundhouses at any place, where such judgment was rendered on account of the making of a valid contract or contracts by such carrier or one of its predecessors in title.

SUPREME COURT, U. S.

FILED

AUG 2 1967

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No. 127

In the Supreme Court of the United States

OCTOBER TERM, 1967

READING COMPANY, PETITIONER

v.

FRANCIS SHUNK BROWN, 3RD, TRUSTEE OF THE ESTATE OF I. J. KNIGHT REALTY CORP., BANKRUPT, AND UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

On November 16, 1962, the I. J. Knight Realty Corporation petitioned for an arrangement under Chapter XI of the Bankruptcy Act. On that day the district court appointed a receiver and authorized him to operate Knight's business of leasing space in the Fretz Building in Philadelphia, Knight's principal asset, and to operate the building for the benefit of its tenants. (Pet. 12; R. 22a.)[1]

[1] "R." references are to the appendix to the brief filed by the appellant in the court of appeals.

271-925—67

On January 1, 1963, the Fretz Building was completely destroyed by a fire that spread to adjoining premises, thus damaging petitioner's property (Pet. 12; R. 22a). On April 3, 1963, petitioner filed a claim in the arrangement for its fire losses, asserting them to be "administrative expenses due to the negligence of the Receiver" in operating the debtor's business. Thereafter, 146 others in the same position as petitioner claimed more than $3,500,000 on the same theory.[2] (Pet. 12; R. 22a–23a.) On May 14, 1963, the debtor was voluntarily adjudicated a bankrupt and a trustee in bankruptcy was elected (R. 20a).

Other claims against the estate—which arose before filing of the arrangement petition—total about $625,000, including federal tax claims of $245,000. Depending on the outcome of the trustee's litigation against Knight's fire insurers, the estate's assets will be between $630,000 and $845,000. (Pet. 13; R. 23a.)

Thus the issue here is whether, as petitioner claims, its damages resulting from the fire may be claimed as "administrative" expenses of the arrangement. If so, then it and the like claims have first priority to payment "in full," and "administrative" expenses will consume the entire estate. If not, the claims of the other statutory priority creditors, including the claim of the United States for taxes, will be satisfied out of funds remaining after the payment of secured claims and the costs of administration.

The trustee in bankruptcy moved to expunge petitioner's claim on the ground that it was not an ad-

[2] The instant case is a test case for all 147 of the claims. (R. 18a–19a, 21a, 23a, 36a–37a.)

ministrative expense (R. 16a).[3] The referee granted the motion (R. 22a–33a). The district court affirmed (R. 35a–48a). The Court of Appeals for the Third Circuit, by a four-to-three decision on rehearing *en banc*,[4] affirmed the district court's holding that the tort claim was not a cost of administering the estate, and was therefore not entitled to a first priority which Section 64a(1) of the Bankruptcy Act, 11 U.S.C. 104(a)(1), gives to administrative expenses. (Pet. 11–22).

The decision of the court of appeals is correct. There is no conflict of decisions, and no occasion for review in this Court.

1. In an ordinary bankruptcy, priorities of unsecured creditors' claims are created and governed solely by Section 64a of the Bankruptcy Act, 11 U.S.C. 104(a). Congress has provided that the same priorities should apply in a Chapter XI proceeding. Bankruptcy Act 302, 11 U.S.C. 702; *American A. & B. Coal Corp.* v. *Leonardo Arrivabene, S. A.*, 280 F. 2d 119, 124 (C.A. 2).

Section 64a(1), 11 U.S.C. 104(a)(1), gives first priority to the "actual and necessary costs and expenses of preserving the estate * * *." When, as in a Chapter XI proceeding, a trustee continues to operate the debtor's business, the courts have allowed such a

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[3] Solely for the purpose of motion to expunge, the trustee conceded that his negligence—imputed from the acts of a plumber he had hired—caused the fire (R. 36a, n. 1).

[4] The appeal was first argued to a three-judge division, but, before decision, the court of appeals *sua sponte* ordered a rehearing before the full court.

first priority to amounts owed suppliers, employees, and others who deal with the estate after the filing of the petition. *White* v. *Murtha*, 343 F. 2d 831 (C.A. 5); *In Re Capital Service*, 136 F. Supp. 430 (S.D. Calif.); *In Re Irving Electrical Supply Co.*, 41 F. Supp. 16 (S.D. N.Y.). By this priority, potential creditors are encouraged to deal with a business that would—without such priority—be a poor credit risk, thus tending to assure the orderly administration of the estate and—particularly important in a Chapter XI proceeding—enhancing the possibility of rehabilitating the debtor. Cf. *Securities & Exchange Comm.* v. *U.S. Realty Co.*, 310 U.S. 434; *Nicholas* v. *United States*, 384 U.S. 678, 684–685, 687; H. Rep. No. 2320, 82d Cong., 2d Sess., pp. 9–10 (2 U.S.C. Cong. & Adm. News (1952) 1960, 1969–1970); S. Rep. No. 1954, 87th Cong., 2d Sess., pp. 5–6 (2 U.S.C. Cong. & Adm. News (1962) 2603, 2607–2608).

As the majority of the Third Circuit held, this rationale does not require giving the first priority of administrative expenses to a claim, such as petitioner's, which sounds wholly in tort. In no manner did the action of Knight's unsecured creditors in proposing an arrangement, and thus consenting to subordinate their claims to those who dealt with the debtor during the arrangement, induce petitioner to deal with Knight or in any way to act differently than it would have if those creditors had instead forced Knight into bankruptcy.

Moreover, the objective of Chapter XI—to encourage the use of arrangements when there is a chance of rehabilitating the debtor—requires the result below.

An arrangement may be proposed by general unsecured creditors; but it cannot be implemented without the consent and forbearance of governments having tax claims and of other statutory priority creditors. That consent is premised on the predictability of the nature and extent of the administrative expenses that will be incurred and attain first priority, during the arrangement. Were tort claims arising during administration given priority equal to the ordinary and expected commercial expenses of running the business during the arrangement, statutory priority creditors would be more likely to exercise their rights, Bankruptcy Act Sections 64a and 337(2), 11 U.S.C., Secs. 104(a) and 737, to insist that either they be paid in full before the arrangement proceeds or that the debtor be forced into bankruptcy.

The result is equally in accord with the congressional intent that may be inferred from the history—however slight—of legislation dealing with the provability of tort claims in bankruptcy. "Historically, bankruptcy laws, both in England and in this country, have dealt primarily and particularly with the concerns of traders", with the result that tort claims could not be proved—and could not be discharged—in bankruptcy. *Schall* v. *Camors,* 251 U.S. 239, 250. Aside from claims reduced to judgment, Congress has provided but one exception—in Section 63a(7) of the Bankruptcy Act 11 U.S.C. 103(a)(7), which allows proof in bankruptcy of negligence claims upon which an action has been instituted and is pending when the bankruptcy petition is filed. No other tort

claims based solely on tortious conduct may be presented to the bankruptcy court. Bankruptcy Act Section 63a, 11 U.S.C. 103; 3 Collier on *Bankruptcy* (Fourteenth ed., 1964), pars. 63.25 and 63.29. Thus, were the priority of an administrative expense given petitioner's claim, one which Congress has generally not allowed to be provable nor dischargeable in bankruptcy, petitioner then would be given a priority ahead of statutory priority claims such as the federal tax claims here in issue, and equal to—and therefore in dilution of—the priority granted to the claims of commercial suppliers who have dealt with the trustees in reliance upon the usual priority rule.

In *Schall* v. *Camors, supra,* this Court held that a tort claim resulting from the bankrupt's fraud was not provable in bankruptcy. There is no greater reason here than in *Schall* "to depart so widely from the precedents as to include mere tort claims," 251 U.S. at 250, among those chargeable against the estate.

2. The decision below is not in conflict with either *Vass* v. *Conron Bros.*, 59 F. 2d 969 (C.A. 2), or *In re Progress Lektro Shave Corp.,* 35 F. Supp. 915 (D. Conn.). *Vass* involved a State court suit by a lessee of a cold storage plant for damages resulting from the bankrupt lessor's failure to refrigerate the building. Although the suit contained an alternative count based on negligence, Judge Learned Hand found "this adds nothing." 59 F. 2d at 970. *In re Progress Lektro Shave Corp.* was a patent infringement suit, where the failure to allow recovery would have resulted in

unjust enrichment of the bankrupt estate. *Cf. American A. & B. Coal Corp.* v. *Leonardo Arrivabene S.A.*, 280 F. 2d 119, 125–126 (C.A. 2); 3 Collier on *Bankruptcy* (Fourteenth ed., 1964), Par. 6325.

In *Schall* v. *Camors, supra,* this Court explicitly anticipated cases such as *Vass* "[w]here the tortious act constitutes at the same time a breach of contract," and cases such as *In re Progress Lektro* "where * * * the tort feasor obtains something of value for which an equivalent price ought to be paid, even if the tort as such be forgiven, there may be a provable claim *quasi ex contractu.*" 251 U.S. at 251. As this Court recognized, such cases raise "a different question" than one such as the present suit involving "a mere tort * * *." *Id.*

3. Petitioner has not, as it claims, been deprived of the right to sue the trustee provided by 28 U.S.C. 959, or of its property without due process. It may, under 28 U.S.C. 959 bring suit, as has an insurance company subrogated to another [redacted] claimant[5] and obtain a judgment if it proves its allegations. To be sure, if Knight's affairs are wound up and the corporation liquidated as a result of the pending bankruptcy proceedings, petitioner will be unable to collect on whatever judgment it may secure. But this would put petitioner in no different circumstance than any claimant against a judgment-proof tort-feasor. Nor does it place petitioner in any worse position than a claimant injured by a tort committed be-

[5] *Home Ins. Co.* v. *Brown*, E.D. Pa., No. 39079, filed October 31, 1965.

fore an arrangement or bankruptcy proceedings whose claim is barred because it is not based on negligence, *Schall* v. *Camors, supra,* or was not filed in the time required by Section 63a(7).

Not all claims in an insolvency situation can be satisfied in full. Congress in the bankruptcy statutes necessarily determined the provability and priority of claims against the estate in the light of all relevant public policy and equitable considerations.[6] Nothing in the Constitution forbids the congressional decision to continue, with the limited exceptions provided in Section 63a, the traditional rule which forbids either payment or discharge of tort claims in bankruptcy. See *Kuehner* v. *Irving Trust Co.,* 299 U.S. 445; *Wright* v. *Union Central Ins. Co.,* 304 U.S. 502; cf. *Goldblatt* v. *Hempstead,* 369 U.S. 590.[7]

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[6] Petitioner's contention that the result below would deter the receivers from carrying insurance (Pet. 5) ignores the fact that the risk of fire loss is one that the owners of a building may insure against more readily than the owners of an adjacent or neighboring building. Moreover, the commercial creditors over whom petitioner seeks priority can in no circumstances insure their claims.

[7] It is by no means as clear as petitioner suggests that it would have been unable to share in the estate as a general unsecured creditor. The only reason for finding that if petitioner filed suit before the adjudication in bankruptcy, it would not qualify for such a share, is Section 378(2) of the Bankruptcy Act, 11 U.S.C. 778(2), which provides that when bankruptcy follows an arrangement, the bankruptcy "proceeding shall be conducted, *so far as possible,* in the same manner and with like effect as if a voluntary petition * * * had been filed and * * * adjudication * * * entered on the [redacted] day when the petition [for the arrangement] * * * was filed * * *." (Emphasis supplied.) Nothing in the statute would bar a holding that it is not "possible"

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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AUGUST, 1967.

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to give effect to the earlier date in order to allow a claim for a tort committed during the arrangement and resulting in the filing of a suit before the bankruptcy.

U.S. GOVERNMENT PRINTING OFFICE: 1967

UPREME COURT, U. S.

No. 127

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IN THE

Supreme Court of the United States

October Term, 1967

READING COMPANY, *Petitioner*

v.

FRANCIS SHUNK BROWN, 3RD, *Trustee of the Estate of* I. J. KNIGHT REALTY CORP., *Bankrupt, Respondent*

and

UNITED STATES OF AMERICA, *Respondent*

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR PETITIONER

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In the Supreme Court of the United States

October Term, 1967 **No. 127**

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and

UNITED STATES OF AMERICA, *Respondent*

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR PETITIONER

This is a petition to review a judgment of the Court below affirming a judgment of the District Court, which had affirmed an order of the referee in bankruptcy expunging petitioner's claim from the record.

OPINIONS BELOW

The majority and the dissenting opinions in the Circuit Court of Appeals are reported at 370 F. 2d 624 (3 Cir. 1967) Record App., pp. 50-61. The opinion of the District Court is reported at 242 F. Supp. 337 (E. D. Pa. 1965) Record App., pp. 36-49.

JURISDICTION

The judgment of the Court of Appeals affirming the judgment of the District Court was entered on January 6, 1967. Rehearing was denied on February 13, 1967. The petition for a writ of certiorari was filed on May 4, 1967, and was granted on October 16, 1967. Jurisdiction of the Supreme Court to review this order is conferred by 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. Whether tort claims resulting from the negligence of a receiver in operating the business of a debtor, pursuant to court authorization in a Chapter XI Bankruptcy proceeding, are entitled to priority as "costs and expenses of administration".

2. Whether denial of such priority, with the resulting immunity of debtor's estate from liability for the receiver's negligence, would deprive petitioner and the other tort claimants of their property without due process of law in violation of the Fifth Amendment to the United States Constitution.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The pertinent constitutional provision is the Due Process clause of the Fifth Amendment to the United States Constitution, U.S.C. Const. Amend. V.

The pertinent statutory provisions involved in this case are: Sections 2, 62(a)(1), 63(a)(7) and 64(a)(1) of the Bankruptcy Act, 11 U.S.C. §§11, 102(a)(1), 103(a)(7) and 104(a)(1); and 28 U.S.C. §959(a) and (b).

The texts of the constitutional provision and the foregoing statutes are set out in the Brief App., pp. 23-27, infra.

STATEMENT OF THE CASE

On November 16, 1962, I. J. Knight Realty Corp. (Knight Realty) filed a petition for an arrangement under Chapter XI of the Bankruptcy Act. On the same day the District Court appointed Francis Shunk Brown, 3rd, as receiver and authorized him to operate the business of Knight Realty.

The only significant asset of Knight Realty was an eight-story industrial structure known as the Fretz Building located at Tenth and Diamond Streets, Philadelphia, Pennsylvania. The business of Knight Realty consisted of leasing space in the Fretz Building and operating the building for the benefit of its tenants.

On January 1, 1963, the Fretz Building was totally destroyed by a fire of unusual intensity. The conflagration spread to adjoining premises, damaging or destroying real and personal property of Reading Company (Reading) and others. On April 3, 1963, Reading filed a claim for $559,730.83, which it styled as a claim for "administrative expenses due to the negligence of the Receiver" in operating the business of Knight Realty. In essence, Reading's claim alleged that the receiver was negligent in permitting the fire to start and "spread beyond its normal confines." [1]

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[1] It was stipulated that "All of the well pleaded allegations of fact in the Reading Company's Statement of Claim are to be deemed true for the purposes of the Trustee's Motion to Dismiss or Expunge the Claim of the Reading Co." (Case stated, Record App., pp. 21-22). Briefly, petitioner there alleged that the receiver and its agent, the chief engineer of the Fretz Building, were negligent in that they did not keep the building sufficiently heated to enable the sprinkler system to remain operative; that as a result the sprinkler system was frozen solid on December 31, 1962 and January 1, 1963, and the system was turned off for repairs and left on January 1, 1963, in an unrepaired and inoperative condition; that, when engaged in turning off the sprinkler system, the chief engineer made an improper electrical connection which ultimately caused the fire; and that the fire spread beyond its normal confines because the sprinkler system was inoperative and, in its absence, no fire watch was maintained. (Proof of Claim, Record App., pp. 4-16.)

Thereafter, other fire loss claimants filed 146 additional claims for administrative expenses based on the alleged negligence of the receiver. The total of all such claims including Reading's exceeds $3,500,000. The referee has ruled that this will be a "test case" which will determine if the fire loss claimants are entitled to prove their losses as expenses of administration. Record App., pp. 18-20.

On May 14, 1963, Knight Realty was adjudicated a bankrupt pursuant to a voluntary consent to adjudication filed on its behalf, and respondent Francis Shunk Brown, 3rd, was subsequently elected trustee in bankruptcy.

Other claims filed in the matter consist of: federal tax claims of $244,953.91; other tax claims of $70,823.19; secured claims of $230,619.04; unsecured claims of $76,-905.47; and wages, $860.00.

It was estimated that the trustee would have on hand between $630,000 and about $845,000, depending on the outcome of certain litigation against fire insurance companies then pending.

The trustee petitioned the court to expunge Reading's claim on the ground that it was not an administration expense within the meaning of the Bankruptcy Act. The referee granted the motion and expunged Reading's claim, not only as an expense of administration but also as an unsecured general claim. The District Court affirmed the order of the referee. The Court of Appeals affirmed the decision of the District Court, with three judges dissenting.

The United States of America has been named as a respondent because it opposed petitioner below. The United States has filed a federal tax claim against the estate which would not be paid if petitioner's position is sustained, because of the insufficiency of the estate.

SUMMARY OF ARGUMENT

Petitioner contends that the tort claims arising out of the negligence of the receiver in operating the debtor's business pursuant to court authorization are entitled to priority of payment as "costs and expenses of administration" for the following reasons:

1. Costs and expenses of administration in bankruptcy proceedings and their priorities of payment are governed by Section 64(a)(1) of the Bankruptcy Act which gives them a first priority. Since Congress did not indicate what it meant by the phrase "costs and expenses of administration," it is reasonable to assume that it intended the words to have the usual and ordinary meaning which they have in normal business practice and which they have acquired in the equity law of insolvent and distressed debtor's estates, and the courts have generally so construed it.

2. Claims arising out of torts committed by receivers, whether in equity receivership or bankruptcy, have always been given priority status as costs and expenses of administration, and all text writers agree that this is the law.

3. Claims arising out of the receiver's torts in operating the debtor's business are as much an expense of operation as are taxes, wages and materials and supplies, and are entitled to equal priority as costs and expenses of administration. All courts, including this Court, have so treated them.

4. The construction of the Bankruptcy Act adopted by the court below immunizing receivership funds from liability for the torts of the receiver operating the business, in competition with others, for the benefit of pre-bankruptcy creditors (a) nullifies the Act of Congress making receivers liable for their acts while carrying on a bankrupt's business (28 U.S.C. §959), and (b) is so arbitrary and capricious as to violate the due process clause of the Fifth Amendment.

ARGUMENT

I. THE TORT CLAIMS ARE CLEARLY ENTITLED TO PRIORITY AS "COSTS AND EXPENSES OF ADMINISTRATION" UNDER SECTION 64(a)(1) OF THE BANKRUPTCY ACT.

A. *Section 64(a)(1) of the Bankruptcy Act Gives First Priority to Costs And Expenses of Administration."*

The receiver was appointed pursuant to a petition filed under Chapter XI of the Bankruptcy Act, 11 U.S.C. §§701-799, and the debtor was later adjudicated a bankrupt.[2] Section 64 of the Bankruptcy Act, 11 U.S.C. §104, sets forth the priority of payment of debts, with the relevant portion of the section reading as follows:

> "Section 64. Debts which have priority.
>
> (a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; . . ."[3]

Section 62(a)(1), 11 U.S.C. §102(a)(1), is the source of authorization to the bankruptcy court for the payment of administration expenses. It provides for the reporting under oath, and examination and approval or disapproval

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[2] Section 302 of Chapter XI (11 U.S.C. §702) provides that the provisions for ordinary bankruptcy (Chapters I-VII) ". . . shall, insofar as they are not inconsistent with or in conflict with this chapter, apply in proceedings under this chapter."

[3] The full text of Section 64 is contained in the Brief App., pp. 25-26 infra.

by the court of "the actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates. . . .[4]

Neither Section 62 nor Section 64 defines the meaning of the term "costs and expenses of administration."

B. *Since Congress Did Not Define "Costs and Expenses of Administration," It Must Have Intended the Term to Include Normal Business Practice and what Had Become Established as Proper Costs and Expenses under the Practice in Equity.*

Congress did not undertake to define what it meant by the term "costs and expenses of administration" as used in either Section 62(a)(1) or Section 64(a)(1) of the Bankruptcy Act; and a careful reading of the Bankruptcy Act reveals no discussion whatever by Congress of what it meant by the term. 3 Collier on Bankruptcy, §62.02(1) (14 ed. 1964). From this it can be assumed that Congress had in mind normal business practice and also what have been established as costs and expenses under the practice in equity.

The Bankruptcy Act specifically provides in Section 2 that the bankruptcy court is a court of equity. Bankruptcy Act, Section 2, 11, U.S.C. §11. Brief App., p. 23 infra.

As was said by this Court, in the case of *Securities & Exchange Commission v. U. S. Realty Co.*, 310 U.S. 434 (1940), in discussing Chapters X and XI of the Bankruptcy Act, at page 457:

> "Good sense and legal tradition alike enjoin that an enactment of Congress dealing with the bankruptcy should be read in harmony with the existing system of equity jurisprudence of which it is a part."

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[4] Section 62(a)(1), is set forth in the Brief App., p. 24, infra.

The principle was reiterated in the recent case of *Bank of Marin v. England*, 385 U.S. 99 (1967), where this Court said at p. 103:

> "There is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction."

See also 3 Collier on Bankruptcy, §62.03 et seq (14th ed. 1964).[5]

As will be seen later, all of the equity cases, without exception, give claims arising out of the torts of a receiver priority status as costs and expenses of administration.

Congress provided in 28 U.S.C. §959(b) (Brief App., p. 27 infra) that a receiver who operates the business of a debtor shall do so subject to the same requirements of law and in the same manner as if he were the debtor.[6] This, coupled with equitable considerations, necessarily requires that the receiver's operation of a business under a Chapter XI proceeding be subject to such risks and liabilities as are normally entailed in a business operation, including tort claims. 3 Collier on Bankruptcy (14th ed. 1964) §62.15, pp. 1539-40.[7]

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[5] In 3 Collier on Bankruptcy §62.03, p. 1414 (14th ed. 1964), it is stated with respect to Section 62.

> "As a matter of substantive law the court is instructed to order approved costs and expenses to be paid or allowed *out of the estate in which they were incurred.* This provision codifies what equity would seem to require unless the administration of estates be unconditionally treated as a governmental function exercised by salaried officers." (Italics in original.)

[6] This Court may judicially note that operations under Chapter XI may extend over lengthy periods of time during which a receiver or debtor-in-possession is in competition with others who assume tort liability as a normal business risk.

[7] In 3 Collier on Bankruptcy, 14th Ed., §62.15 (pp. 1537-40) it is stated:

> "Section 2a (5) empowers the court to authorize the business of bankrupts to be conducted for a limited period by a marshall, receiver or trustee. Such continued operation of a

C. *The Few Bankruptcy Cases which Have Discussed the Problem Have Treated Tort Claims against Receivers and Trustees as Expenses of Administration.*

Petitioner has found only one case which involves the precise issue of whether a tort claim against a trustee in bankruptcy is an expense of administration entitled to priority under the provisions of the Bankruptcy Act. That case is *In re Progress Lektro Shave Corporation*, 35 F. Supp. 915 (D. Conn. 1940). There the trustee sold articles protected by a patent belonging to the claimant after notice by the patentee of his rights. The court held that the sale was an infringement of the claimant's rights and ordered

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business is in substance a means of preservation, namely as a going concern, sometimes with a view to rehabilitation and bridging a critical period, more frequently in preparation for a more advantageous sale of the assets. Expenditures incurred by continued operation of a bankrupt's business will, therefore, on principle follow the rules outlined in §62.14 as to expenditure in connection with preservation. *The difference, if any, lies in the greater variety of types of expenses, rather than in their legal treatment, provided always that the business is conducted under special and express authority of the court.* . . .

"As compared to where property is merely to be protected from deterioration or loss, employment of assistance in a going concern is necessarily of a wider scope. Power to hire help within the reasonable needs of a business is implied in the authority to conduct a business. Salaries and wages are among the recognized costs of continuing business, as are expenses incurred for rent and for necessary material and merchandise. . . .

"The officer's tax duties and liabilities . . . gain particular importance during operation of a business. . .

"Among other expenses incident to conducting a business and therefore allowable as administrative expenditure may be royalties for a patented process of manufacture, fees of detectives hired to discover persons involved in theft of assets, *payments on claims for personal injuries inflicted in the operation of a business*, rent, insurance, commissions, cost of raw material or merchandise purchased for manufacturing or resale *and any other expense ordinarily attendant upon active participation in commercial or industrial life.*" (Emphasis added.)

that the "claim be allowed in the amount of $1000 with the priority pertaining to an expense of administration." The court said at page 916:

> "Holding, as I do, that upon the facts as found by the Referee the sale by the trustee was in violation of the claimant's rights, it follows that the claim must be allowed as an expense of administration."

A case of greater authority, although the precise issue of priorities was not directly involved, is *Vass v. Conron Bros. Co.*, 59 F. 2d 969 (2d Cir. 1932). There a trustee in bankruptcy who was operating a cold storage plant permitted the refrigeration to fail so that perishable goods belonging to a lessee were spoiled. The lessee sued the trustee in the state court alleging breach of contract and negligence and the trustee obtained an order enjoining the prosecution of the suit. The Court of Appeals affirmed the granting of the injunction in an opinion by Judge Learned Hand, in which that respected judge held that the damages sustained by the lessee were payable as expenses of administration. He stated at page 971:

> ". . . the liquidation of the lessee's resulting damages was as much a part of the usual administration in bankruptcy, as that of the pay of accountants, custodians or other assistants, employed by the trustee."

It has been suggested (we believe erroneously) that this is dictum. Dictum or not, it is an unqualified expression of opinion by this eminent jurist and is entitled to great weight, particularly in view of the dearth of bankruptcy decisions on this point.

There are no cases contrary to the above two cases.[8]

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[8] As pointed out in the dissenting opinion in the court below (370 F. 2d at p. 630, Record App., p. 60), none of the cases cited by the court in support of its refusal to apply the equity rule involved tort claims.

The paucity of cases on the subject is probably due to the fact that damages or personal injuries caused by the negligence of receivers and trustees are normally covered by liability insurance, and the bankrupt estate would therefore not be directly involved.[9]

The recent case of *In re Hudson & Manhattan Railroad Company*, 178 F. Supp. 103 (S.D.N.Y. 1959) affirmed sub nom *Angus v. Stichman*, 273 F. 2d 707 (2 Cir. 1960), is particularly significant. There priority status in the administration of the estate of the debtor, which was in reorganization under Chapter X of the Bankruptcy Act,[10] was sought for 91 employee and non-employee claims arising prior to the appointment of the receiver. The court described

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[9] In its brief in opposition to the petition for certiorari, respondent trustee states (p. 5):

> "Surely at other times and places torts have been committed by bankrupts to or against property contiguous to theirs, or to persons in the vicinity of or on a bankrupt's property, or by vehicles belonging to bankrupts. No case, however, has been found in which a contention similar to that of the present petitioner has been made. The reason for the absence of cases may be that the liability insurance proceeds were adequate to pay losses incurred. In the present situation the fire was of woefully unique proportions, and no reasonably foreseeable insurance coverage could possibly have been adequate or even carried."

It is submitted that the existence of insurance coverage is not a proper criterion for determining the priority status of a tort claim.

[10] Debtor did not qualify as a railroad company entitled to reorganization under Section 77 of the Bankruptcy Act. This was so ruled in the above case. It is true that under Chapter X, it is specifically provided (11 U.S.C. §515) that the receiver shall operate the property as a receiver in equity and therefore Section 64(a)(1) may not be applicable. Nevertheless it has been recognized that Chapter X receiverships are fundamentally similar to, if not indistinguishable from, Chapter XI proceedings where a receiver or debtor-in-possession has been authorized by the court to continue a business. See Hirsch & Krause, *Bankruptcy, Arrangements under Chapter XI*, p. 81 fnl. The distinction between Chapters X and XI has been thin, if not illusory, since this Court's decision in *S.E.C. v. U.S. Realty and Improvement Co., supra*, p. 7.

the debtor's business as having "two interrelated aspects: the ownership and operation of an interurban electric railway and the ownership and operation of two large office buildings and other real estate in downtown Manhattan in the City of New York" (p. 104). In denying priority status to all of the claims, the court stated (p. 104):

> "It is well established that all tort claims against a Debtor which has gone into receivership are to be denied priority *if the claims ante-dated the receivership.*" (Emphasis added.)

It is obvious from the above quotation that the court would have permitted priority status if the tort claims had arisen during the receivership, as is the case here.

D. *All of the Text Writers State Categorically that Tort Claims against Receivers Generally Are Allowable as Expenses of Administration Without Making any Distinction between Receivers in Equity or Bankruptcy.*

The following are typical quotes from the texts:

45 Am. Jur., Receivers, §255 (1943):

> "It is a general rule that claims arising out of authorized transactions with the receiver or out of the conduct of the receivership, including those based on the proper costs and expenses of the receivership, and on the torts of the receiver or his agent in the administration of the receivership, are the ranking claims against the estate in receivership."

45 Am. Jur., Receivers, §349 (1943):

> "A receiver operating a railroad or other property or business generally is liable . . . for his torts or negligence in such operation or for the torts or negligence of his agents and employees in such operation. . . . Such liability is deemed part of the operating expenses of the receivership."

2 Clark, Receivers, §396(h) (3rd ed. 1959):

> "When a receiver is appointed to operate a business he may be guilty of tort. For instance a receiver is frequently appointed in foreclosure proceedings to manage and conserve the property which may consist of buildings or plants which must be kept in operation. In operating such buildings, the receiver or his subordinates may be guilty of acts or failure to act or negligence which will result in a tort. . . .
>
> "Damages resulting from the operation of the plant or in business being incidental to the management generally become part of the expense of administration by the court."

2 Clark, Receivers, §640.9 (3rd ed. 1959):

> "Costs and expenses may include torts arising out of operation of property.
>
> "In the operation of a railroad or other property, torts may be committed directly by the receiver or indirectly by his agents. Under our American system of jurisprudence a receiver when properly obeying the orders of court is liable officially and not personally.
>
> "Damages for injuries to persons or property during the receivership and resulting from the operation thereof by the receiver are part of the operating expenses of the receivership and payable first out of income and second out of the corpus."

75 C. J. S., Receivers, §293(h), page 943 (1952):

> "Damages for injuries to persons or property during a receivership, caused by the torts of the receiver's agents or employees, are classed as part of the operating expenses and are entitled to the preference accorded to claims of that character."

3 Collier on Bankruptcy, §62.15, page 1540 (14th ed. 1964):

> "Among other expenses incident to conducting a business and therefore allowable as administrative expendifure may be . . . payments of claims for personal injuries inflicted in the operation of a business. . . ."

E. *Tort Claims Have Always Been Given Priority as Costs and Expenses of Administration in Equity Receiverships.*

All of the equity receivership cases hold that claims for damages arising out of the torts of the receiver are costs of administration.

In *Sneedon v. Industrial Commission*, 366 Ill. 552, 10 N.E. 2d 327 (1937), it was held that compensation for injuries sustained by an employee of the receiver was an "expense of receivership."

In *Cowdrey v. Galveston, Houston and Henderson Ry. Co.*, 93 U.S. 352 (1876), the court said at page 354:

> "The allowance for goods lost in transportation, and for damages done to property whilst the road was in the hands of the receiver, was properly made. The earnings received were as much chargeable with such loss and damage as they were chargeable with the ordinary expenses of managing the road. The bondholders were only entitled to what remained after charges of this kind, as well as the expenses incurred in their behalf, were paid."

In *Farmers' Loan and Trust Co. v. Northern Pacific Railroad*, 74 Fed. 431 (C.C.D. Ore. 1896), the court recognized that equity requires payment of damages incurred during the operation of the receivership to be paid even prior to the first mortgage lien. In that case preference over the mortgage was denied for damages which occurred *prior* to the receivership. The court said at page 433:

> "Such claims for injuries occurring under the receiver's own management are paid, it is true, in preference to the mortgage debt, not for the reason of their preferential nature, nor because of any superior equity in their favor over claims for damages which arose before the receiver was appointed, but because they are liabilities which were incurred by the receiver in the course of his own operation of the road, and are payable by him as other expenses of the management."

In upholding an equity railroad receiver's contract for indemnity from injury to third parties (not employees), the court said in *Farmers' Loan and Trust Co. v. Carolina, C.G. & C. Ry. Co.*, 93 Fed. 543 (4 Cir. 1899) at p. 562:

> "It will not be disputed that a court of equity, which puts property in the charge of its receiver . . . will provide for the payment of all the *necessary* expenses incurred in the proper administration of the estate, before it orders distribution among creditors; and, if the receiver had operated this road himself, there can be little doubt that the court would have ordered the payment of all of these claims in priority to any claims of the bondholders. . . . That he may incur ordinary operating expenses is not disputed. This embraces all salaries of employees, ordinary supplies of material, and all expenses for keeping road and rolling stock in order; and the courts have held that *claims for damage to either person or property are included in the general class of operating expenses.*" (Emphasis added.)

See also *Union Trust Co. v. Illinois Midland Railway Co.*, 117 U.S. 434, 464-65 (1886).

In the case of *Anderson v. Condict*, 93 Fed. 349 (7 Cir. 1899), which involved the Englewood & Chicago Electric Street Railway Co., the same contention was made

as is urged by the respondents. The court said at pages 353-54:

> "But it is said that claims for personal injuries happening during the operation of the road by a receiver cannot be allowed, as a cost of administration, in priority to the receiver's certificates; . . . Technically, perhaps, payment for personal injury cannot correctly be denominated cost of operation; *but it is an expense incurred in and by reason of the operation*, and as such should be allowed in the accounts of the receiver. Klein v. Jewett, 27 N.J. Eq. 474. That such was the meaning of these decrees seems to us incontestable." (Emphasis added).

In *Bereth v. Sparks*, 51 F. 2d 441 (7 Cir. 1931), Sparks obtained a judgment against the receiver of a national bank on the theory that the receiver was a joint tort-feasor with the bank, and brought a bill in equity to have the judgment declared an administration expense entitled to priority over general creditors. The lower court held that the judgment was entitled to priority and the Court of Appeals of the 7th Circuit affirmed. The court stated, at page 442:

> "In the instant case, however, substantial evidence was introduced to the effect that the receiver was a joint tort-feasor ab initio, and in such event the following principles of law are applicable:
>
> " 'Damages, for injuries to persons or property during the Receivership, caused by the torts of the receiver's agent and employees, are classed as a part of the operating expenses of the corporation. Such expenses are to be paid and are payable out of the income of the property, if it is sufficient; or, if necessary out of the corpus. (Citing cases) . . . We think that Court properly held that appellant's claim constitutes an administration expense and is entitled to priority over general creditors.' "

A large collection of cases to the same effect is listed in the annotation to 28 U.S.C.A. §959, Note 626. Suffice it to say that petitioner has been unable to find a single case in which personal injuries or property damages caused by the receiver, or his agent, after the commencement of the receivership, were denied priority.

The court below stated (370 F. 2d, p. 627, Record App., p. 55) that it found no compelling persuasion in the foregoing cases, because the expression "costs and expenses of administration" in Section 64(a)(1) is a "purposeful statutory restriction" and the Federal courts cannot extend its reach or sweep "beyond its clearly defined provisions."[11] In the first place, petitioner disagrees that Section 64(a)(1) is a "purposeful statutory restriction" since it speaks broadly of "the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition." There is no restriction in this language as to the items of costs or expenses of administration. Moreover, the portion of Section 64(a)(1) with which we are here dealing is far from being "well defined." There are no definitions. That is why the parties are required to resort to other sources, including equity receivership proceedings, to ascertain its proper construction.

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[11] In support of its findings that the words "costs and expenses of administration" are a "purposeful statutory restriction," the Court below relies heavily on *In re Connecticut Motor Lines, Inc.*, 336 F. 2d 96 (3 Cir. 1964), where it was stated that the 1962 amendment to Section 64(a)(1) was intended to restrict "costs and expenses of administration." Senate Report No. 1954, accompanying the amending legislation, H.R. 5393, August 28, 1962, U.S. Code Congressional and Administrative News, p. 2603 (1962), does not support this statement. The Senate Report clearly shows that the purpose of the amendment was to make more specific the scope of superpriority of claims for costs and expenses of administration in a superseding, liquidating bankruptcy proceeding over cost and expenses of administration in the debtor-relief proceeding. No such problem is involved here.

The language of Section 64(a)(1) standing alone has a clear meaning in the business world. If a party undertakes to operate a business, he must expect to incur expenses, not only for wages, materials, supplies and taxes, but also for any tort liabilities resulting from his operations. There is nothing in the language of the Bankruptcy Act which states that a receiver operating a debtor's property is exempt from any of these recognized costs of operating a business. Nor is there any need for the courts to "amend by judicial legislation," or to "extend the reach or sweep of," the language employed by Congress in Section 64(a)(1), as the court below indicated would be required before tort claims could be entitled to a priority status as costs and expenses of administration.

By every test—ordinary meaning of the words, accepted business practice, equitable principles, court decisions and writings of all recognized authorities on bankruptcy—the tort claims here involved clearly are entitled to priority as costs and expenses of administration of the debtor's estate.

F. *Damages Resulting from the Receiver's Negligence Are Just as Much an "Expense" of Conducting a Debtor's Business as Are Taxes, Wages, Materials and Supplies.*

The court below suggested (370 F. 2d, p. 628, Record App., p. 56) that decisions under the Internal Revenue Code holding that expenses to be deductible must be related to the preservation of the property or business supported its decision. What the court overlooked is that tort claims are "necessary expenses" of conducting business and deductible as such. See *Anderson v. Commissioners of Internal Revenue*, 81 F. 2d 457 (10 Cir. 1936); *Plante v. United States*, 226 F. Supp. 314 (D. N. H. 1963); Annotation, 20 A.L.R. 2d 600, Income Tax: Deductibility of amount paid or expense incurred by taxpayer on account of his liability or alleged liability for tort, crime or statutory violation.

The Department of Justice states at pp. 3-4 of its Memorandum in Opposition that "When, as in a Chapter XI proceeding, a trustee continues to operate the debtor's business, the courts have allowed such a first priority to amounts owed suppliers, employees, and others who deal with the estate after the filing of the petition." It rationalizes that, "By this priority, potential creditors are encouraged to deal with a business that would—without such priority—be a poor credit risk, . . ." The Department goes on to argue that "this rationale does not require giving the first priority of administrative expenses to a claim, such as petitioner's, which sounds wholly in tort."

Certainly such an argument, if valid, would be equally applicable to tax claims accruing during the administration of debtor's estate and require their exclusion. Yet, such tax claims are accorded a first priority as an expense of administration. 3 Collier on Bankruptcy, §62.14, p. 1529 (14th ed. 1964). See also, dissenting opinion of the court below, 370 F. 2d 628-29, Record App., pp. 57-8.

II. The Effect of the Judgment of the Lower Court Is Violative of Due Process.

It is obvious from the foregoing that this Court need not reach a Constitutional question in order to reverse the court below. However, we submit that the effect of the refusal of the lower court to allow the claim of petitioner is a violation of the due process clause of the Fifth Amendment.

Unless the damage claims arising out of the fire are allowed as expenses of administration they have no standing at all. The general claims outlined in Section 63 of the Bankruptcy Act are debts incurred by the bankrupt prior to the filing of the petition. Obviously these fire claims are not obligations of the debtor since the operation of the business had been taken out of its hands at the time of the fire. There is no specific provision in Section 64, the priority section, relating to claims arising out of the receiver's torts,

nor is there any general provision which could include them other than "costs and expenses of administration." It therefore follows that unless the claims are expenses of administration, neither the bankrupt estate nor the receiver personally has any responsibility whatever to the persons damaged by the fire.[12]

In the absence of some reasonable basis for the denial of these rights and the immunization of the bankrupt estate from tort claims, this is a violation of due process. See *Louisville Bank v. Radford*, 295 U.S. 555 (1935); *Wright v. Union Central Life Insurance Co.*, 304 U.S. 502 (1938); 1 *Remington on Bankruptcy* (Henderson ed. 1950).[13] As we have pointed out above, there is no reasonable basis for granting such immunity.[14]

The Department of Justice asserts (Memorandum in Opposition, p. 7) that petitioner has suffered no injury because it still has the right to sue the trustee. The answer is that such a suit is utterly meaningless. While the suit is nominally against the trustee, it is actually against the

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[12] The receiver is not personally liable nor does he have any responsibility after his discharge. This Court so held in *McNulta v. Lochridge*, 141 U.S. 327 (1891), where it stated at page 332:

> "Actions against the receiver are in law actions against the receivership, or the funds in the hands of the receiver, and his contracts, misfeasances, negligences and liabilities are official and not personal, and judgments against him as receiver are payable only from the funds in his hands."

[13] 1 Remington on Bankruptcy §11, p. 23 (Henderson ed. 1950) states as follows:

> "Within the proper range, Congress is not required to leave creditors the right to the full and untrammeled result of use of the usual common-law remedies to enforce their obligations. It must, however, respect property rights and other fundamental rights under the constitution and general restrictions upon its powers except to the extent reasonably necessary to deal adequately with bankruptcies and insolvency situations."

[14] Moreover, to do so would run counter to the general recognition today that tort immunity has little justification. See, e.g. *United States v. Muniz*, 374 U.S. 150, 165-66 (1963).

bankrupt estate since the trustee has no personal responsibility. *McNulta v. Lochridge*, 141 U.S. 327 (1891). A judgment is not automatically provable in bankruptcy; it depends upon the nature of the claim which gave rise to the suit. *Dickinson v. Universal Service Stations*, 100 F. 2d 753 (9 Cir. 1938). Under the holding below a tort claim against the estate even though reduced to judgment is not provable and therefore unenforceable and completely worthless.[15]

Conclusion

In conclusion we submit that the damages caused by the receiver's negligence must be paid out of the estate as expenses of administration. This result is in accord with business practice, all of the court decisions, the writings of all recognized authorities and the equitable principles which govern the administration of the Bankruptcy Act. A contrary holding would nullify the Act of Congress requiring receivers to operate the debtor's business in accordance with State law and would deprive the victims of the receiver's negligence of their property without due process of law. The judgment of the court below should be reversed.

Respectfully submitted,

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Attorneys for Petitioner

November 29, 1967

[15] The government says that petitioner is "in no different circumstances than any claimant against a judgment-proof tort feasor" (Memorandum in Opposition, p. 7). What this argument ignores is that the tort feasor is judgment proof only because this decision makes him so. The government's analogy to torts committed prior to the bankruptcy proceedings ignores the whole point in this case. It is because the tort was committed by the receiver while operating the business for the benefit of general creditors that these claims are entitled to preferred status.

CERTIFICATE OF SERVICE

STATE OF PENNSYLVANIA:
COUNTY OF PHILADELPHIA: ss.

I, THOMAS RAEBURN WHITE, JR., counsel for the petitioner herein, and attorney of record for petitioner in the courts below, state that on the 29th day of November 1967, I served five copies of the foregoing Petitioner's Brief on the respondents, as required by Rule 33, by personally mailing said copies hereof to Messrs. Dechert, Price and Rhoads, in care of their office, 1600 Three Penn Center Plaza, Philadelphia, Pennsylvania 19102, and on the United States by mailing five copies to the Solicitor General, Department of Justice, Washington 25, D. C., and to Richard M. Roberts, Assistant Attorney General, Department of Justice, Washington, D. C. 20530, the attorney who argued the case for the United States in the courts below.

THOMAS RAEBURN WHITE, JR.
Member of the Bar of the
United States Supreme Court

Appendix to Brief

Amendment V — Capital Crimes; Double Jeopardy; Self-Incrimination; Due Process; Just Compensation for Property

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

11 U.S.C. §11 (Bankruptcy Act §2)

§11. *Creation of courts of bankruptcy and their jurisdiction.*

(a) The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * * * *

(2) Allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates;

11 U.S.C. §102(a)(1) (Bankruptcy Act §62(a)(1))

§102. *Expenses of administering estates; unauthorized sharing of fees; withholding allowances.*

(a) (1) The actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates shall, except where other provisions are made for their payment, be reported in detail under oath, and examined and approved or disapproved by the court. If approved, they shall be paid or allowed out of the estates in which they were incurred.

* * * * *

11 U.S.C. §103(a)(7) (Bankruptcy Act §63(a)(7))

§103. *Debts which may be proved.*

(a) Debts of the bankrupt may be proved and allowed against his estate which are founded upon . . . (7) the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy; . . .

* * * * *

11 U.S.C. §104(a)(1) (Bankruptcy Act §64(a)(1))

§64. *Debts Which Have Priority.*

(a.) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estate, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by

creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks or travel-

ing or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under Chapter 9 of Title 18, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy: *Provided, however,* That no priority over general unsecured claims shall pertain to taxes not included in the foregoing priority: *And provided further,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; (5) debts other than for taxes owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law or who is entitled to priority by paragraph (2) of subdivision (c) of Section 107 of this title: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

28 U.S.C. §959(a) and (b)

§959. *Trustees and receivers suable; management; State laws.*

(a) Trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury.

(b) A trustee, receiver, or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof. June 25, 1948, c. 646 62 Stat. 926.

SUPREME COURT, U.S.
DEC 29 1967
JOHN F. DAVIS, CLERK

No. 127.

IN THE

Supreme Court of the United States

October Term, 1967.

READING COMPANY,

Petitioner,

v.

FRANCIS SHUNK BROWN, 3RD, Trustee of the Estate of I. J. KNIGHT REALTY CORP., Bankrupt,

Respondent,

and

UNITED STATES OF AMERICA,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

BRIEF OF RESPONDENT FRANCIS SHUNK BROWN, 3rd, TRUSTEE.

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IN THE

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October Term, 1967

No. 127

READING COMPANY,

Petitioner

v.

FRANCIS SHUNK BROWN, 3RD, TRUSTEE OF THE ESTATE OF I. J. KNIGHT REALTY CORP., BANKRUPT,

Respondent

and

UNITED STATES OF AMERICA,

Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCIUT

BRIEF FOR RESPONDENT FRANCIS SHUNK BROWN, 3RD, TRUSTEE.

OPINIONS BELOW.

The opinion of the Court of Appeals for the Third Circuit is reported at 370 F. 2d 624 (3d Cir. 1967), and is printed at R. 50. The opinion of the District Court for the Eastern District of Pennsylvania is reported at 242 F. Supp. 337 (E. D. Pa. 1965), and is printed at R. 36. The opinion of the Honorable Thomas J. Curtin, Referee in Bankruptcy is not reported, but is printed at R. 23.

QUESTION PRESENTED.

Is an unliquidated negligence claim against a receiver which arises during a Chapter XI proceeding entitled to a first priority as part of the "costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition" as expressed in Section 64a(1) of the Bankruptcy Act (11 U. S. C. § 104(a)), elsewhere referred to in Section 62a(1) (11 U. S. C. § 102(a)(1)) as "the actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates . . ."

STATUTES INVOLVED.

The pertinent statutory provisions are Sections 17a, 62a(1), 63a(7), 64a and 77n of the Bankruptcy Act, 11 U. S. C. §§ 35(a), 102(a)(1), 103(a)(7), 104(a) and 205(n) respectively. All of these sections have been printed in the appendix to the Brief for Petitioner, pages 23-26 inclusive, except Sections 17a and 77n. Section 17a and 77n are printed in the appendix to this Respondent's Brief, pages 15 to 17.

It is submitted that there are no constitutional issues present here.

STATEMENT OF THE CASE.

On November 16, 1962, I. J. Knight Realty Corporation filed a petition in the United States District Court for the Eastern District of Pennsylvania for an arrangement under Chapter XI of the Bankruptcy Act. Francis Shunk Brown, 3rd, Esquire, was appointed receiver to operate the business of the debtor, whose principal asset was an 8-story industrial structure known as the Fretz Building, located at 10th and Diamond Streets in Philadelphia, Pennsylvania.

On January 1, 1963, a fire of unusual intensity, fanned by winds of exceptionally high velocity completely destroyed the Fretz Building. It was a twelve-alarm fire, and, as the Reading Company alleges, the biggest in the history of Philadelphia (R. 7). The fire also damaged or destroyed adjoining property, including property of the Reading Company.

Thereafter, the Reading Company filed a claim in the bankruptcy proceeding styled a claim for "administration expenses due to the negligence of the Receiver in operation of the business of the debtor" (R. 4, 5). On May 14, 1963, the corporation, being unable to function without the building, was adjudicated a bankrupt pursuant to a voluntary consent to adjudication. The receiver was elected trustee, and as such filed a petition to expunge the Reading Company's claim as not being a "cost or expense of administration" as that term is used in the Bankruptcy Act. The trustee and the Reading Company submitted the issues presented by the trustee's petition on the basis of a case stated (R. 21).

Referee Thomas J. Curtin granted the prayer of the trustee's petition in an opinion and order which holds that the Reading Company's claim does not qualify as a cost or

expense of administration under Section 64a(1) and is not provable as an unsecured claim under Section 63 of the Act (R. 23). In an opinion and order dated June 9, 1965, the Honorable Francis L. Van Dusen of the District Court for the Eastern District of Pennsylvania, affirmed Referee Curtin's order (R. 36). Subsequently, a majority of the United States Court of Appeals for the Third Circuit affirmed Judge Van Dusen's order (R. 50, 370 F. 2d 624).

The total of the Reading Company's claim is $559,730.83 (R. 21). Similar property damage negligence claims exceed $3,500,000. In the case stated (R. 21, 22), it was agreed that federal tax claims totaled $244,953.91; and other claims, both secured and unsecured, are roughly itemized totalling $379,207.70 (R. 22). It was also agreed therein that the trustee would have between $630,000 and about $845,000 to distribute.

SUMMARY OF ARGUMENT.

If this Court were to rule that negligence claims arising during bankruptcy are entitled to the highest priority available in the Bankruptcy Act, the ends of justice would be defeated.

That it is the province of Congress to establish priorities in bankruptcy distribution has been firmly recognized by this Court. That these should be strictly adhered to has likewise been recognized.

Section 64a of the Bankruptcy Act sets forth the order of priorities. These are:

1. The costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition (and a number of other named items);

2. Wages and commissions up to $600 per claimant earned within three months of bankruptcy;

3. Certain expenses of creditors objecting to a discharge;

4. Taxes;

5. Debts and rent owing under certain other laws.

To grant the very highest priority to the negligence claim here would result in all the other priority claims being wiped out, not only in this case but in future cases as well.

That Congress has had a conscious purpose narrowly to interpret the administration expense priority has been recognized by this Court.

Section 63a(7) of the Bankruptcy Act provides that where a suit for negligence has been instituted prior to and is pending at the time the bankruptcy petition is filed, the negligence claim may be proved. Section 77n provides that in railroad receiverships and reorganizations, personal injury claims of injured employees shall be preferred and paid as operating expenses. Apart from these sections, the Bankruptcy Act is silent on proof or allowance of tort claims.

That equity receivership cases furnish no authority for interpretation of the Bankruptcy Act has been recognized by this Court.

ARGUMENT.

1. A Reversal of the Court Below Would Not Do Equity.

A ruling by this Court that any negligence damages which Reading Company can establish are to have the highest priority the statute gives will not produce an equitable result, but quite the reverse.

This case is not concerned with immunity from tort liability. It is concerned only with administration under the Bankruptcy Act. Obviously, that Act cannot furnish a procedure for the payment of claims in full. It reflects only the judgment of Congress as to which claims should be paid first where there are insufficient funds for all. However one may disagree with the pattern adopted by Congress, the legislative intention is manifest, and has been adhered to by the tribunals below. This Court should not engraft onto the legislation affecting distribution a result which Congress does not intend.

Proof of certain claims is provided for in Section 63. The only tort claims which Congress has permitted to be proved are those founded upon ". . . the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy. . . ." (Section 63a(7), 11 U. S. C. § 103(a)(7)). The only tort claims allowed any priority are those of injured railroad employees in railroad reorganizations and receiverships. These are required to be paid out of operating expenses by Section 77n (11 U. S. C. § 205(n)). Since these are the only two instances in which the statute provides for the allowance of tort claims, or even for their proof, the claim presented by Reading Company in this case, which meets neither of these statutory requirements, should not be granted a priority above all others.

The priorities, as listed in Section 64a (11 U. S. C. § 104(a)) are:

1. Costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition (and a number of other items not relevant here);

2. Wages and commissions up to $600 per claimant earned within three months of bankruptcy;

3. Certain expenses of creditors objecting to a discharge;

4. Taxes;

5. Debts and rent owing under certain other laws.

In the present case, and very likely in future cases as well, a reversal of the Court below as requested by Reading Company would mean that there would be nothing left for the payment of any of those priority claimants. If any change is needed in the order of priorities, it should be brought about by Congress, not through litigation. Congress has amended the Bankruptcy Act to reflect changing conditions and changing views (*Collier on Bankruptcy*, 14th Edition, Volume 1, pages 7 to 27 inclusive). Before doing so, it conducts hearings so that those learned in bankruptcy law, and those with first hand experience may have an opportunity to express their views and give Congress assistance in this technical field. Changes should be effected through this procedure, and not by engrafting onto the Act, through litigation, the very radical change which the Reading Company now suggests, but which Congress has never intended.

In *United States v. Speers*, 382 U. S. 266 (1965) this Court recognized that changes in the Act should be made by Congress. The issue, which was not germane to the present

one, was whether a trustee in bankruptcy should be considered a statutory "judgment creditor" so as to prevail over an unrecorded federal tax lien. In holding that he should, this Court, speaking through Mr. Justice Fortas, said at pages 276 and 277:

> "Whether this result is inadvisable need not detain us, for the question is one of policy which in our view has been decided by Congress in favor of the trustee . . . . Should experience indicate that inclusion of the trustee within Section 6323 is inadvisable, the fact will not be lost upon Congress."

The question here is likewise one of policy with respect to tort claims based upon negligence. Congress has enunciated its policy in enacting Sections 63a(7) and 77n. It ". . . knows how to assure the priorities it desires", as the Court below recognized (R. 54). If it should desire to change the law with respect to negligence claims arising during bankruptcy, it will no doubt do so. We cannot and should not assume that it will grant such claims a priority ahead of all the already existing priorities.

If the fire which destroyed the bankrupt's only asset had occurred prior to the Chapter XI proceeding, while the premises were still being operated by the owner, there would have been no question here as to the fate of the property damage claims. If bankruptcy had ensued following such a fire, such claimants, if they had promptly started suit prior to the filing of the petition in bankruptcy, would have been entitled to prove their claims under the provision of Section 63a(7), but they would not have enjoyed any priority status under Section 64a(1). Had they not started suit in time, their claims would not have been provable. In that situation, no contention would or could have been made that any sum realized through fire insurance,

however large, would have been available for the payment of such tort claims ahead of all other claimants. No businessman, whether trustee, receiver or otherwise, would have considered carrying liability insurance in a sum sufficient to cover the property damage caused by this holocaust, even if it were available. This Court is not being asked to decide whether the trustee should have been permitted to carry on the business untrammeled by responsibility for negligence. The question before the Court in this case is the construction of the provisions of the Bankruptcy Act having to do with priorities. This Court has recognized that ". . . if one claimant is to be preferred over others, the purpose should be clear from the statute". *Nathanson, Trustee, v. National Labor Relations Board*, 344 U. S. 25, 29 (1952).

2. The Terms of the Bankruptcy Act Require Affirmance of the Judgment of the Court Below.

This case involves a construction of the Bankruptcy Act and not the principles applicable to any other type of equity proceeding or receivership.[1] This Court recognized the difference in *United States v. Speers*, 382 U. S. 266 (1965), referred to earlier at page 8. Mr. Justice Fortas at 382 U. S. 270 pointed out that a case relied on by the

1. The fire which caused property damage arose during arrangement proceedings under Chapter XI, and not in the ensuing bankruptcy which superseded the Chapter XI proceedings. There is no legal significance in this circumstance so far as the question before this Court is concerned, and none of the parties at any stage of the proceedings have contended otherwise. The reason for this is that Section 302 of the Bankruptcy Act (11 U. S. C. § 702) provides that Chapters I to VII of the Act, which include Sections 1 to 72, apply equally to proceedings under Chapter XI as to bankruptcy. The fact that the trustee has been referred to here and there in the Reading Company's brief as a receiver is therefore of no significance as far as the legal result is concerned.

losing party, *United States v. Gilbert Associates, Inc.*, 345 U. S. 361 (1953), arose out of a state insolvency proceeding, and did not involve a bankruptcy proceeding or the rights of a trustee in Bankruptcy.

This Court has acknowledged the concern of Congress that priorities under the provisions of § 64(a) should be narrowly construed: *Goggin, Trustee v. Division of California Labor Law Enforcement*, 336 U. S. 118 (1948). The case involved a tax claim of the United States which was secured by a perfected lien. At page 127 of 336 U. S., this Court, speaking through Mr. Justice Burton, alluded to the "conscious purpose to give a narrowly limited priority to administration expenses." Essentially the same purpose was recognized in *In The Matter of Connecticut Motor Lines, Inc.*, 336 F. 2d 96 (3d Cir., 1964), relied on by the three tribunals below (R. 28, 41, 53). It was pointed out in that case that Section 64a(1) was not intended as a "catch-all" (336 F. 2d at p. 102).

In support of its argument, Reading Company has cited numerous old railroad reorganization and equity receivership cases. These are not relevant in construing the Bankruptcy Act. They do furnish authority for the quotations from the text writers contained in the Reading Company's brief. These quotations, in turn, apply to equity receiverships. The texts quoted contain many other pages dealing with the Bankruptcy Act, quite separate from those quoted on receiverships. In the discussions of bankruptcy, there is no mention of tort claims as administration expenses: e.g. *9 Am. Jur. 2d, Bankruptcy* (1963), Vol. 9, § 534 and §§ 1626 to 1652; Clark, *Law of Receivers* (3d Ed., 1959), Vol. 4, pp. 1787 to 1935; *Corpus Juris Secundum*, Vols. 8 and 8A, § 451 et seq., especially § 455. *In re Progress Lektro Shave Corp.*, 35 F. Supp. 915 (D. Conn. 1940) and *Bereth v. Sparks*, 51 F. 2d 441 (7th Cir., 1931), cited at

pages 9 and 16 of Reading Company's brief, involve an element of unjust enrichment. To have denied a priority would have been to have deprived claimant of his own property. *Sneeden v. Industrial Commission,* 366 Ill. 552, 10 N. E. 2d 327 (1937), cited at page 14, involved a claim which was allowed not because it sounded in tort, but because specifically authorized by statute. *Vass v. Conron Bros. Co.,* 59 F. 2d 969 (2d Cir., 1932) cited at page 10 by Reading Company, is simply not on point. Judge Hand was not concerned with negligence, as he plainly said; and held only that the bankruptcy court was the proper forum to liquidate the claimant's claim. The portion of the opinion quoted was plainly dictum.[2]

The Reading Company has lost no substantive rights. Section 17a of the Bankruptcy Act (11 U. S. C. § 35) provides that a discharge in bankruptcy releases only provable debts. Those which cannot be proved are not discharged. *Collier on Bankruptcy,* 14th Ed., Vol. 1, § 17.03, pp. 1582 and 1583. The Judicial Code, 28 U. S. C. § 959(a), provides for plenary suits against trustees.[3] The Reading Company has been deprived of no constitutional rights. Congress has considerable discretionary power in bankruptcy: *Remington on Bankruptcy,* 5th Edition, Vol. 1, § 14, pages 29 and 30; *Kuehner v. Irving Trust Co.,* 299 U. S. 445 (1937).

Bankruptcy in the early days affected almost entirely the affairs of merchants and traders. Claims arising out

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2. Of the "large collection of cases" referred to by Reading Company at the top of page 17 (which are 32 in number), none is more recent than 1925. Most show by their names that they are railroad cases.

3. Indeed counsel for the Reading Company have already started one for another client, a subrogated fire insurance carrier: *The Home Insurance Company v. Francis Shunk Brown, III, Receiver and Trustee of the Estate of I. J. Knight Realty Corp.,* Civil Action No. 39079, now pending in the U. S. District Court for the Eastern District of Pennsylvania.

of negligence were rare, created few problems, and went unrecognized: *Schall v. Camors, Trustee,* 251 U. S. 239, 250 (1920). Industry intensified. With this intensification, tort claims inevitably arose; and Congress permitted proof of them under the conditions prescribed in Section 63a(7). It was early discovered that railroads could not operate without accidents occurring to employees: *Farmers Loan and Trust Co. v. C. C. G. & C. Ry. Co.,* 93 F. 543, 551 (4th Cir. 1899). The equity receivership rule recognizing their claims was codified by Congress into the present Section 77(n). Since Congress has recognized negligence claims to this limited extent, it is submitted that this Court should go no farther. If recognition is to be extended beyond the present statutory provisions, the extension should be made by Congress.

CONCLUSION.

For the reasons stated it is respectfully submitted that the judgment of the United States Court of Appeals for the Third Circuit should be affirmed.

Respectfully submitted,

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APPENDIX TO BRIEF.

Section 17a of the Bankruptcy Act (11 U. S. C. § 35(a)).

Section 17. Debts Not Affected by a Discharge. a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy: *Provided, however,* That a discharge in bankruptcy shall not release a bankrupt from any taxes (a) which were not assessed in any case in which the bankrupt failed to make a return required by law, (b) which were assessed within one year preceding bankruptcy in any case in which the bankrupt failed to make a return required by law, (c) which were not reported on a return made by the bankrupt and which were not assessed prior to bankruptcy by reason of a prohibition on assessment pending the exhaustion of administrative or judicial remedies available to the bankrupt, (d) with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat, or (e) which the bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has not paid over; but a discharge shall not be a bar to any remedies available under applicable law to the United States or to any State or any subdivision thereof, against the exemption of the bankrupt allowed by law and duly set apart to him under this Act: *And provided further,* That a discharge in bankruptcy shall not release or affect any tax lien; (2) are liabilities

for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious injuries to the person or property of another, or for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for breach of promise of marriage accompanied by seduction, or for criminal conversation; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor, if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; (5) are for wages which have been earned within three months before the date of commencement of the proceedings in bankruptcy due to workmen, servants, clerks, or traveling or city salesmen, on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; or (6) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment.

Section 77n of the Bankruptcy Act (11 U. S. C. 205(n)).

(n) In proceedings under this section, and in equity receiverships of railroad corporations now or hereafter pending in any court of the United States, claims for personal injuries to employees of a railroad corporation, claims of personal representatives of deceased employees of a

railroad corporation, arising under State or Federal laws, and claims now or hereafter payable by sureties upon supersedeas, appeal, attachment or garnishment bonds, executed by sureties without security, for and in any action brought against such railroad corporation or trustees appointed pursuant to this section, shall be preferred and paid out of the assets of such railroad corporation as operating expenses of such railroad. No judge or trustee acting under this Act shall change the wages or working conditions of railroad employees except in the manner prescribed in the Railway Labor Act, as amended June 21, 1934, or as it may be hereafter amended. No reorganization effected under this Act and no order of the court or Commission in connection therewith shall relieve any carrier from the obligation or any final judgment of any Federal or State court rendered prior to January 1, 1929, against such carrier or against one of its predecessors in title, requiring the maintenance of offices, shops, and roundhouses at any place, where such judgment was rendered on account of the making of a valid contract or contracts by such carrier or one of its predecessors in title.

SUPREME COURT, U. S.

No. 127

In the Supreme Court of the United States

OCTOBER TERM, 1967

READING COMPANY, PETITIONER

v.

FRANCIS SHUNK BROWN, 3RD, TRUSTEE OF THE ESTATE OF I. J. KNIGHT REALTY CORP., BANKRUPT, AND UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES

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In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 127

READING COMPANY, PETITIONER

v.,

FRANCIS SHUNK BROWN, 3RD, TRUSTEE OF THE ESTATE OF I. J. KNIGHT REALTY CORP., BANKRUPT, AND UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the district court (R. 36–49) is reported at 242 F. Supp. 337. The majority (R. 50–56) and dissenting opinions (R. 56–61) of the court of appeals are reported at 370 F. 2d 624.

JURISDICTION

The judgment of the court of appeals was entered on January 6, 1967 (R. 62). A petition for rehearing was denied on February 13, 1967 (R. 3). The petition for a writ of certiorari was filed on May 4, 1967, and was granted on October 16, 1967 (R. 63). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether tort claims resulting from a fire caused by the negligence of the receiver having control of the debtor's estate during an arrangement under Chapter XI of the Bankruptcy Act are entitled in an ensuing bankruptcy to the priority in payment that Section 64a(1) of the Act gives the "unpaid costs and expenses of administration" of the arrangement.

STATUTE INVOLVED

The relevant statutory provisions, Sections 62a(1), 63a(7), and 64a of the Bankruptcy Act are set out in the Appendix, *infra*.

STATEMENT

On November 16, 1962, I. J. Knight Realty Corporation petitioned for an arrangement under Chapter XI of the Bankruptcy Act. On that day the district court appointed a receiver and authorized him to operate the debtor's business of leasing space in the Fretz Building in Philadelphia, the debtor's principal asset, and to operate the building for the benefit of its tenants (R. 36, 51).

On January 1, 1963, the Fretz Building was completely destroyed by a fire of unusual intensity that spread to adjoining premises, thereby damaging the property of petitioner and others (R. 36–37, 51). On April 3, 1963, petitioner filed in the arrangement a claim of approximately $560,000 for its fire losses, asserting that they were "administrative expenses due to the negligence of the Receiver" in operating the debtor's business. Thereafter, 146 others filed claims

on the same theory. The total of all such claims, including petitioner's, exceeds $3,500,000.[1] On May 14, 1963, the debtor was voluntarily adjudicated a bankrupt and a trustee in bankruptcy was elected. (R. 37, 51; see also R. 4–16.)

Other claims against the estate—which arose before the filing of the Chapter XI petition—total about $625,000, including federal tax claims of $245,000.[2] Depending upon the outcome of pending litigation against the debtor's fire insurers, the estate's assets will be between $630,000 and $845,000. (R. 38, 51 n. 2.)

The trustee in bankruptcy moved to expunge petitioner's claim on the ground that it was not "one of the actual and necessary costs and expenses incurred * * * in the administration of estates." (R. 17, 37, 51.) Solely for the purpose of the motion to expunge, the trustee conceded that the receiver's negligence—imputed from the acts of a plumber he had hired—caused the fire and its spread (R. 18, 37). The referee, agreeing with the trustee that the petitioner's claim was neither an administrative expense nor a general provable claim (R. 23–34), granted the motion (R.

[1] The instant case is a test case for all the claims (R. 19–20, 22, 24, 37–38).

[2] Most of the Government's tax claim will not be affected by Sections 2 and 3 of the Act of July 5, 1966, P. L. 89-496, 80 Stat. 270, which amended Sections 17 and 64a(4) to provide for the discharge, and exclude from the fourth priority, such taxes as became legally due and owing more than three years preceding the adjudication in bankruptcy.

Of the total tax claims here asserted, up to $16,523.69 may be secured by liens on real property and therefore would be superior to administrative expenses.

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34). The district court affirmed (R. 36–49). The Court of Appeals for the Third Circuit, by a four-to-three decision on rehearing *en banc*,[3] affirmed the district court's holding that the tort claim was not a necessary cost of administering the estate and therefore was not entitled to a first priority pursuant to Section 64a(1) of the Bankruptcy Act, 11 U.S.C. 104a(1) (R. 50–61).[4]

SUMMARY OF ARGUMENT

I

The Bankruptcy Act requires that the definition of administrative expenses of Section 62a and the priorities established in Section 64a, and not the rules developed in non-statutory equity receiverships, govern the determination of whether the tort claims of petitioner are entitled to the priority status that Section 64a(1) accords the administrative expenses of an arrangement under Chapter XI in an ensuing bankruptcy. Those sections make clear that administrative expenses include only those which were "necessary" to the preservation of the debtor's estate. In cases such as the arrangement here, where the bankruptcy court has allowed the debtor's business to continue to operate, such expenses are limited to those essential to such operation—for example, amounts due suppliers and workmen who, during the arrangement, sell goods

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[3] The appeal was first argued to a three-judge panel, but, before decision, the court *sua sponte* ordered a rehearing before the full court.

[4] In the court of appeals, the petitioner agreed that its claim was not provable as a general claim under Section 63a(7) of the Bankruptcy Act, 11 U.S.C. 103a(7) (R. 52, n. 3).

and provide services to the business. The reason for such a priority is to allow the business to continue, and thus seek rehabilitation.

Petitioner and others who sufferred damages as a result of the Fretz Building fire acted no differently than they would have in the absence of the arrangement. Nor did the continuation of the arrangement in any way increase their risk of loss. Thus, although there might be circumstances in which tort claims arising during an arrangement might be entitled to first priority—as when a business invitee is injured—there is nothing in this case that requires petitioner to have such a priority in order to encourage the rehabilitation of business through Chapter XI arrangements.

Nothing in the Bankruptcy Act would have barred petitioner from filing a claim as a general unsecured creditor, if it had complied with the requirement of Section 63a(7) that it file suit before bankruptcy. The availability of the general fund to satisfy claims arising from torts commited during the arrangement adequately protects the public interest in encouraging careful conduct of the business.

Moreover, to grant petitioner a first priority would impede the implementation of the policy Congress has adopted in Section 63a(7). It would as well hamper the prompt liquidation of contingent or uncertain claims, for which Congress has provided in Section 57(d).

Considerations of essential fairness, moreover, require that petitioner not have a first preference. The result would be to exclude the general creditors and those having subordinate priorities. This would be

contrary to the Congressional purpose of restricting priorities and maximizing the fund available to general creditors. In addition, it was petitioner and the similarly situated claimants who were better able to insure against their fire loss, and upon whom the loss should therefore rest.

II

Congress has expressly provided that the rules governing equity receiverships, on which petitioner relies, should be utilized in reorganizations under Section 77 and Chapter X of the Bankruptcy Act. The statute provides, in contrast, that the rather different rules of ordinary bankruptcy should apply to arrangements under Chapter XI. Moreover, in reorganizations the existence of the original corporate entity terminates, so that there is a need to make provisions for payment of all claims against the original entity, including those based on torts committed during the reorganization period. There is, accordingly, no basis for applying the "equity" rules in cases under Chapter XI.

But even were the equity rules to be applied petitioner's claim should be subordinated to that of the United States, since such rules do not automatically treat tort claims as first priority expenses.

ARGUMENT

INTRODUCTION

This case, as does any growing from a debtor's bankruptcy, revolves about the creditor's forced participation in a game of musical chairs. By definition someone will lose; the essential issue is which of the competing parties has the priority that will allow its

claim to be satisfied first from a fund inadequate to pay all.

In such cases there are three general aims: to conserve the debtor's estate, to administer it in an orderly fashion, and to do such equity as is possible in distributing the remains to the claimants. Because these objectives are more easily stated than implemented, Congress has adopted a comprehensive Bankruptcy Act, which defines the claims that may be presented and the order in which they should be satisfied. Those statutory provisions must of course control this case.

Because the proceeding here is an ordinary liquidating bankruptcy, the priorities are determined by Section 64a of the Bankruptcy Act. The United States' unsecured tax claims undisputedly have a fourth priority that places them behind administrative expenses, Section 64a(1), and workmen's claims, Section 64a(2), but ahead of the claims of general unsecured creditors. The claims of petitioner and the others to whose premises the Fretz Building fire spread come ahead of the tax claims only if they properly constitute administrative expenses. Otherwise, such claimants either must share with the general creditors who have no priority, or seek satisfaction outside the bankruptcy court.

Section 64a(1) gives the first priority to "the costs and expenses of administration * * *." The same subsection provides that where an ordinary bankruptcy follows upon another proceeding under the Bankruptcy Act, such as the Chapter XI arrangement here, the "unpaid costs and expenses of administration" of the earlier proceeding are to share in the first priority, although subordinately to the administrative expenses

of the bankruptcy. Chapter XI has no express definition of the "costs and expenses of administration" of an arrangement. It adopts by reference, however, "the statutory provisions" applicable in ordinary bankruptcy "insofar as they are not inconsistent with or in conflict with the provisions of" Chapter XI: Section 302, 11 U.S.C. 702. It is settled that the effect of this language is to measure claimed administrative expenses of the arrangement by the standards applied in an ordinary bankruptcy. *E.g., American A. & B. Coal Corp.* v. *Leonardo Arrivabene, S.A.*, 280 F. 2d 119, 124 (C.A. 2).

The court's authority to allow payment of the administrative expenses of a bankruptcy is conferred by Section 62a(1) of the Act: "The actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates" may be paid if they "be reported in detail under oath, and examined and approved * * * by the court." In granting such expenses a first priority, Section 64(1) lists several that should be included. The first such category comprehends "the actual and necessary costs and expenses of preserving the estate subsequent to filing of the petition * * *."

The phrase "actual and necessary"—included in both Section 62a(1) and Section 64a(1)—must be the beginning point of the analysis of this case. Because the dividing line between the includable and the excludable is not clear, the solution must be sought in the several policies underlying the Bankruptcy Act and its priority provisions.

Petitioner essentially relies upon the cases that have allowed tort claims to be paid as administration expenses in reorganizations under Chapter X and Section 77 of the Bankruptcy Act, as well as in equity receiverships. But, contrary to petitioner's thesis, these authorities do not automatically grant such claims the first priority of expenses of administration. Indeed, it is taxes that have the top priority in ~~Chapter X proceedings~~ reorganizations—by reason of Section 199 of the Act, which does not apply in ordinary bankruptcies and Chapter XI arrangements.

There is a further, and more fundamental, defect in petitioner's position. Although Congress has with some statutory modification adopted rules developed in the administration of equity receiverships for use in proceedings under Chapter X and Section 77, it has at the same time adopted a rather different set of rules—set forth mainly in Sections 62a(1) and 64a(1)—for the administration of ordinary bankruptcies, arrangements under Chapter XI, and proceedings under Chapters XII and XIII of the Bankruptcy Act.

For these reasons, the rules governing receiverships are not applicable to the problems posed in this case. Rather the fashioning of the proper rule here ultimately requires analysis of two questions relating to the policies that Congress has applied to ordinary bankruptcies: What are the objectives Congress sought to achieve in using the word "necessary" in defining in Section 62a the administration expenses of arrangements and bankruptcies that receive a first priority under Section 64a? and how would the first

priority petitioner claims square with the general place that Congress intended tort claims to have in ordinary bankruptcies?

I. THE CLAIMS OF PETITIONER AND OTHERS DAMAGED THROUGH THE SPREAD OF THE FIRE ARE NOT ENTITLED TO THE PRIORITY ACCORDED COSTS AND EXPENSES OF ADMINISTRATION OF AN ARRANGEMENT UNDER CHAPTER XI OF THE BANKRUPTCY ACT IN AN ENSUING BANKRUPTCY

A. THE WORD "NECESSARY" IN SECTIONS 62a(1) AND 64a(1) SHOULD BE APPLIED IN A MANNER THAT IMPLEMENTS THE CONGRESSIONAL PURPOSE OF LIMITING CLAIMS GIVEN PRIORITY IN ORDER TO PROMOTE THE RELIEF OF GENERAL UNSECURED CREDITORS AND OF CREDITORS HAVING SUBORDINATE PRIORITIES

The history of the present Bankruptcy Act, which dates to 1898, shows that Congress has on several occasions changed the priority provisions of Section 64a. In each significant instance the result has been to limit, and not to expand, the category of claims accorded priority; the continuing purpose has been to enlarge the fund available to creditors having a subordinate priority or no priority at all.

For example, in 1926, tax claims were demoted from first to essentially fourth priority, and the priority given real estate taxes was limited. See Section 15 of the Act of May 27, 1926, Ch. 406, 44 Stat. 662. The reason was that the prior statute had left "little or nothing in the estate for general creditors and subordinate priority claimants." 3 *Collier on Bankruptcy,* par. 64.402, at p. 2156. Then, in 1938, Congress eliminated the statutory provision that accepted in bankruptcy such priorities as State statutes created. The purpose

was to eliminate the multitude of additional priorities that States had given a variety of claims, including those sounding in tort,[5] with the consequent *de facto* exclusion of general creditors. See Analysis of H.R. 12889, 74th Cong., 2d Sess., p. 201; 3 *Collier, supra,* par. 64.01, p. 2054, n. 27. See also *Groggin* v. *California* Labor Div., 336 U.S. 118, 127–129, n. 8; 3 *Collier, supra,* par. 64.501. Most recently, in 1966, the fourth priority given pre-bankruptcy tax claims was limited to amounts that have accrued within three years preceding the bankruptcy; experience had shown that unknown claims for past taxes were often so unpredictably large that "little or nothing was left for distribution to general creditors who provided goods and services to the bankrupt" (H. Rep. No. 687, 89th Cong., 1st Sess., pp. 3–4). See Sections 2 and 3 of P.L. 89–496, 80 Stat. 270; 3 *Collier, supra,* par. 64.01, pp. 2058–2061.

Congress has not dealt in such specificity with the administrative expenses given the first priority as it did in these amendments. Yet it is clear that Congress, in using the word "necessary," has sought to impose a significant limitation on the nature of the expenditures that may receive the first priority.

The history of national bankruptcy legislation is marked by many changes resulting from continuing controversies over which creditors shall be paid, and in which order. But one of the most constant features

[5] In at least eleven States, statutes had given tort claims varying degrees of preference. See *e.g.*, *Rial* v. *Chatman*, 70 F. 2d 21 (C.A. 4); Underhay, Tort Claims in Receivership and Reorganization, 22 Iowa L. Rev. 60, 81 (1936).

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has been the limitation of allowable administrative expenses to "necessary" ones.

The word has been in every bankruptcy act since that of 1841. The short-lived [6] act of that year directed the district courts to promulgate rules "to avoid all unnecessary expenses" in the administration of bankrupt estates. See Section 6 of the Act of August 19, 1841, Ch. IX, 5 Stat. 440. The next national bankruptcy act was adopted in 1867. For the full 11 years of its existence [7] it provided that the assignee—*i.e.*, the trustee—"shall be allowed, and may retain out of money in his hands, all the necessary disbursements made by him in the discharge of his duty * * * ." Section 17 of the Act of March 2, 1867, Ch. CLXXVI, 14 Stat. 517. Sections 62 and 64 of the modern Act, first adopted in 1898, have always referred to the "actual and necessary" expenses of administration.[8] See Section 62 and 64 of the Act of July 1, 1898, 30 Stat. 544, 562, 563.

The courts must determine what are the "necessary" expenses of administration of each bankruptcy and arrangement. An essential guide is the reference in Section 64a(1) to "preserving the estate subsequent

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[6] The Act of 1841 was repealed by the Act of March 3, 1843, Ch. LXXII, 5 Stat. 614.

[7] The Act of 1867 was repealed by the Act of June 7, 1878, Ch. 160, 20 Stat. 99.

[8] The draftsman of the original bill that later became the Bankruptcy Act of 1898, c. 541, 30 Stat. 544 stated, (S. Doc. No. 156, 55th Cong. 2d Sess., p. 11) "The * * * expenses [other than the compensation fixed for referees and trustees] will be only such as are actual and necessary; they will not be paid until they have been reported in detail under oath and allowed by the court."

to filing the petition." Thus the focal point has been the determination of the nature and degree of the benefit a particular expense confers on a particular insolvent estate.

One of the earliest cases stating this general rule is *Randolph* v. *Scruggs,* 190 U.S. 533. At issue was the allowability and priority status in bankruptcy of fees for services attorneys had rendered to the insolvent estate during a prior assignment for the benefit of creditors— a procedure analagous to the arrangement at issue here. Mr. Justice Holmes, speaking for an unanimous Court, held that fees for advice given the assignee could be included in the assignee's expenses of administering the estate, which then as now had a first priority. But not all such fees were to be allowed. "We are not prepared," the Court stated, "to go further than to allow compensation for services which were beneficial to the estate." 190 U.S. at 539.

This same approach has resulted in a continuing judicial attempt to recognize (*In Re Connecticut Motor Lines, Inc.* 336 F. 2d 96, 100 (C.A. 3)):

> a cleavage between allowing as first priority matters * * * [expenses] arising from post-bankruptcy activities geared towards development or preservation of the bankrupt's assets, but disallowing as an expense of administration, * * * [those] attaching to post-bankruptcy activities incidental to the development or preservation of the bankrupt's assets. * * *

Thus in *Connecticut Motor Lines,* the Third Circuit refused to give a first priority to taxes withheld from

wages paid upon the windup of a bankruptcy, because the wages related to services rendered before the bankruptcy was adjudicated. First priority also has been denied a use tax levied after adjudication on an incompleted ship built before bankruptcy, notwithstanding the availability of the vessel as an asset of the estate. *In Re Mt. Washington S.S. Co.*, 43 F. Supp. 176 (D.N.H.)

The usual dispute over the administrative expenses of an ordinary bankruptcy goes to such items as the alleged excessiveness of a legal fee charged the trustee, or the allowability within the first priority of items, such as taxes, that grow out of transactions antedating bankruptcy but become payable thereafter. However, the problem is somewhat different when, as in a Chapter XI proceeding, a receiver, trustee or debtor continues to operate an insolvent business. In these circumstances the category of administrative expenses is enlarged to include at least some expenses that are "necessary" in the sense that without the goods or services which they represent the business would be unable to operate. Thus the courts have included within administrative expenses amounts owed suppliers, employees, landlords, and other who deal with the estate after the filing of the petition. *White* v. *Murtha*, 343 F. 2d 831 (C.A. 5); *In Re Capital Service*, 136 F. Supp. 430 (S.D. Calif.); *In Re Irving Electrical Supply Co.*, 41 F. Supp. 16 (S.D.N.Y.). Similarly, taxes arising from transactions entered into during the arrangement are given the priority of administrative expenses, since the business continues to have the use and protection of govern-

mental services and facilities. See 3 *Collier, supra,* par. 62.14[3]; *Swarts* v. *Hammer,* 194 U.S. 441; see, also, *Nicholas* v. *United States,* 384 U.S. 678, 691–693.

By such a priority, people are encouraged to work for or sell to a business that—without such priority—would be unable to pay them, and governments are encouraged to allow the business to continue. As a result, the priority enhances the possibility of rehabilitating the debtor, a particularly important objective in a Chapter XI proceeding. Cf. *Securities & Exchange Commission* v. *U.S. Realty Co.,* 310 U.S. 434; *Nicholas* v. *United States,* 384 U.S. 678, 684–685, 687; H. Rep. No. 2320, 82d Cong., 2d Sess., pp. 9–10; S. Rep. No. 1954, 87th Cong., 2d Sess., pp. 5–6.

But not every expense of operation acquires the first priority. For example, in *Denton & Anderson Co.* v. *Induction Heating Corp.,* 178 F. 2d 841, the Second Circuit refused to include within administrative expenses sales commissions on orders that had been secured before, but not filled until after, the filing of the Chapter XI petition. As that case demonstrates, the word "necessary" is given a relatively narrow construction—to include within the first priority only such operating expenses as are essential to assure that the insolvency existing on the date the arrangement begins has as neutral as possible an influence on the ability of the business to operate thereafter.

Thus, we submit, the essential question here is whether allowance of petitioner's tort claims as an administrative expense is necessary to allow the continuation, and thereby the rehabilitation, of such insol-

vent businesses as that of I. J. Knight Realty Corporation.

B. THE POLICIES THAT ALLOW A FIRST PRIORITY TO CERTAIN OPERATING EXPENSES OF CHAPTER XI ARRANGEMENTS DO NOT JUSTIFY GIVING THE SAME TREATMENT TO PETITIONER'S TORT CLAIMS

Without the first priority of administrative expenses, workmen, suppliers, and others who are asked to deal with the business during the arrangement would not have a realistic hope of full payment; they would be unlikely to deal with the debtor and the arrangement could not proceed. Through the priority, the debtor can deal with such people upon a slate relatively unmarred by the pre-existing insolvency.

This is the reason for granting the first priority, and it is a policy with a limited purpose. We submit there is no justification for giving its application a scope which exceeds its essential function. Its entire thrust is to induce volitional dealings with a business that would otherwise be terminated because of its insolvency. To exclude from the priority tort claims such as the one involved here is not, as the dissenters below suggested (R. 59), to say that "contractual claims are unjustifiably exalted" over those sounding in tort. Rather, it is to recognize that the Fretz Building fire and its spread in no manner involved volitional acts on the part of petitioner and the similarly situated claimants.

These claimants all necessarily acted in the same manner as they would have if the Knight Company had remained solvent or had been adjudicated a bankrupt before the fire—and in the latter instance

Section 63a(7) of the Act, which limits the provability of claims founded upon negligence to those that are the subject of a court suit filed before bankruptcy (see pp. 20–26, *infra*), would have barred the assertion of their claims in the bankruptcy proceeding. In addition, whether or not there had been an arrangement, the building would have remained in existence, the sprinkler system would have presumably required repair, and petitioner's property would have remained nearby. It thus cannot even be said that the continuation of the business in some manner made the risks of damage to such persons as petitioner greater than those that would have been incurred in the absence of the arrangement. Therefore, the reasons that allow a first priority status to various operating expenses in no way apply to whatever damages resulted from this particular fire.

This analysis does not require the conclusion that a tort resulting from the negligent operation of a business during an arrangement may never be a "necessary" cost of the administration. It is to say only that each case must be analyzed in its own context, and be decided according to the nature and degree of relationship between the operation of the business during the arrangement and the tort. For example, an injury to a member of the public—a business invitee—who was injured while on the business premises during an arrangement would present a completely different problem. The activity—the opening of a store to would-be customers or an office to a potential supplier—would be an integral and

essential element of the continuation of the business, and any hopes it may have of rehabilitation. The invitee has through a voluntary act entered upon the premises with a view to dealing with the debtor. To be sure, the entry on the premises would not have been made with the expectation of injury, or with any reliance on the prospect of claims for an injury receiving a first priority. On the other hand, such an injury could not occur in the absence of the arrangement—since without it the business would not have continued to operate—so that it may cogently be argued in such a case that the reasons that have led to the grant of priority to the contractual claims of employees and suppliers should equally apply.[9]

Nor would denial of the first priority to petitioner mean, as the dissenters below argued (R. 59), that "the risks to which the public is exposed by torts which experience shows are an inevitable result of the operation of a business are treated as outcast." The necessary premise for this assertion is the theory that petitioner and other tort victims would have no recourse except as a claimant within the first priority. But there is no support for this view in either the statute or the cases. The only support is petitioner's own disclaimer (Br. 19), which the referee and district court accepted (R. 25, 33, 44, 45; see also R. 59) of the ability to share in the estate as a general unsecured creditor.

[9] Comparable arguments could be advanced in support of a variety of tort claims—for example, one based on injuries inflicted during an arrangement by the negligent operation of a delivery truck is arguably entitled to priority on the theory that the truck would not have been operating in the absence of the arrangement.

Petitioner did not file a timely claim as a general unsecured creditor, and did not file suit in the time Section 63a(7) requires; it is now barred from recovery in this bankruptcy proceeding unless it obtains a first priority. See *In re Connecticut Motor Lines, Inc., supra,* at p. 108; *Denton & Anderson Co.* v. *Induction Heating Corp., supra,* at pp. 843–844. But if petitioner had filed such proof and suit, there would be no basis for excluding its claim.[10]

Because such a claim may share in the general fund, there is no need to grant a first priority to avoid the result which the dissenters below predicted and we agree should be avoided—the failure of trustees to secure public liability insurance. A trustee's principal obligation is to the general creditors. His duty is to maximize their shares in the estate. The

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[10] The only reason for finding that if petitioner filed suit before bankruptcy, it would not qualify for a share as a general creditor is Section 378(2) of the Bankruptcy Act, which provides that when bankruptcy follows an arrangement, the bankruptcy "proceeding shall be conducted, *so far as possible*, in the same manner and with like effect as if a voluntary petition * * * had been filed and * * * adjudication * * * entered on the day when the petition [for the arrangement] * * * was filed * * *." (Emphasis supplied.) Nothing in the statute would bar a holding that it is not "possible" to give effect to the earlier date, if such effect would disallow a claim for a tort committed during the arrangement and resulting in the filing of a suit before the bankruptcy. On the contrary, *Nicholas* v. *United States*, 384 U.S. 678, 685 n. 13, suggests that Section 378(2) would not be interpreted in a manner that would treat petitioner's claim as though it had arisen after the arrangement turned into a bankruptcy, and thereby, see, *e.g.*, *Favelo* v. *Reeves*, 227 U.S. 625, 631, bar it from proof in the bankruptcy proceeding altogether. But see *Valdes* v. *Feliciano*, 267 F. 2d 91 (C.A. 1).

prospect of tort claims being charged against the general fund is no less a deterrent upon the trustee than would be a grant of first priority. And if petitioner could not have claimed the status of general creditor, the result would be that the tort claim would not be discharged, so that the trustee's fiduciary duty to the debtor should result in his carrying the requisite insurance.

C. THE GRANT OF A FIRST PRIORITY TO TORT CLAIMS WOULD CONFLICT WITH THE GENERAL TREATMENT OF SUCH CLAIMS IN BANKRUPTCY

Claims for damages resulting from torts have traditionally been disfavored in bankruptcy. The precise reason is shrouded in antiquity. This Court has suggested that the original reason was that "Historically, bankruptcy laws, both in England and in this country, have dealt primarily and particularly with the concerns of traders." *Schall* v. *Camors,* 251 U.S. 239, 250. Thus, in *Schall* v. *Camors,* this Court held that a tort claim resulting from the bankrupt's fraud was not provable in bankruptcy.

Whatever may have been the original purpose of excluding claims founded in tort from being proved—and from being discharged—in bankruptcy, Congress in 1934 reviewed the question, and decided to allow a single limited exception. It added to the claims which Section 63 makes provable what is now Section 63a (7) (See Act of June 7, 1934, 48 Stat. 911, Section 4(a)):

> Debts of the bankrupt may be proved and allowed against his estate which are founded

> upon * * * (7) the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy; * * *

Under this provision only tort claims sounding in negligence may be proved and discharged in bankruptcy, and negligence claims qualify only if the claimant has instituted an action in court before a petition in bankruptcy has been filed. Although Congress did not expressly elucidate the reasons for these limitations, the policies underlying each are reasonably apparent.

The limitation to cases sounding in negligence excludes from bankruptcy claims arising from intentional torts. The rule thereby avoids a tortfeasor's using the procedures of bankruptcy to avoid the consequences of a purposeful wrong.

The requirement that suit be filed as a prelude to proving claims based on negligence, such as petitioner's, appears to have a distinct purpose—to complement and enhance the authority of the bankruptcy court to minimize delay in the distribution of a bankrupt estate by expediting the liquidation of contingent or uncertain claims. This policy is expressed in Section 57(d):

> * * * an unliquidated or contingent claim shall not be allowed unless liquidated or the amount thereof estimated in the manner and within the time directed by the court; and such claim shall not be allowed if the court shall determine that it is not capable of liquidation or of reasonable estimation or that such liquidation or estimation would unduly delay the administra-

tion of the estate or any proceeding under this title.

This proviso suggests that the rule limiting the provability of claims based on negligence reflects the impediment to the administration and distribution of the estate that inheres in the delay attendant upon proving the existence of negligence and the extent of resulting damages. See 3 *Collier on Bankruptcy, supra,* par. 57.15 at pp. 226–234, par. 63.25. Section 63a(7) ameliorates this potential for delay by requiring that judicial liquidation of the negligence claim at least be under way when the bankruptcy proceedings begin. At the same time, this procedure provides the bankruptcy court with significant flexibility in determining the manner in which the tort claim is to be liquidated, for the court has the option of allowing the negligence action to proceed where it was instituted, or instead enjoining the negligence action and having it tried and determined in the bankruptcy court. Compare *Matter of Baldwin,* 291 U.S. 610, 615; *Matter of United Button Co.,* 140 Fed. 495, 498 (D. Del.), affirmed, 149 Fed. 48 (C.A. 3).

To grant petitioner a first priority would contravene these policies. Congress plainly intended that claims based on negligence have no greater status than those of general unsecured creditors. The fact that the Fretz Building fire occurred during a Chapter XI arrangement is merely fortuitous, and provides no justification for promoting petitioner's claim to the first priority in a manner directly contrary to the provisions of Sections 63a(7) and 57(d). Petitioner advances no reason why it should be relieved

of the responsibility of filing a suit before the adjudication in bankruptcy. Nor is there any reason why petitioner should be allowed to avoid the authority Section 57(d) gives the bankruptcy court to control the liquidation of the negligence claim in the manner best suited to expeditious administration of the bankrupt estate.

The allegations underlying this case indeed demonstrate the intended interaction of Sections 63a(7) and 57(d), and the manner in which a grant of first priority would frustrate that interplay. A bankruptcy court might well conclude that the issues of negligence and proximate cause might better be resolved in a state trial court. But petitioner's approach deprives the court of this option.

An even more obvious example relates to the items of loss and expense that petitioner included in its itemized claim of damages (R. 13–16). Various types of railroad equipment are alleged to have been damaged in amounts ranging from $187 to $164,000. An extensive array of railroad operations is claimed to have been needed to clear the grades and make repairs. Additional expenses of $60,000 for unloading cars and chartering buses are said to have resulted from the inability to use certain facilities (R. 15–16). There is a claim of a loss of $39,000 in revenue over a ten-day period (R. 16).

A trial of extensive proportions, going into numerous details of the railroad business and the Reading Company's own operations, is essential to evaluate these specific claims of damages. No one can tell from the present record how long such an evaluation will

take, and what is the most expeditious manner of resolving the matter. Perhaps it can all readily be resolved by stipulations before the referee. On the other hand, the court's best judgment might be that a jury decision, based on expert testimony, would be the better approach. But whatever the bankruptcy court might decide, Section 57(d) contemplates that the court should have the utmost flexibility in directing the manner of liquidation. Section 63a(7) complements this authority by making available to the bankruptcy court a relatively prompt decision by a traditional trial, if this is deemed to be the best approach. Yet, the necessary result of allowing the procedure which petitioner seeks is completely to tie the hands of the bankruptcy court and its referee. If petitioner's claim is made an administrative item, the estate cannot be wound up until the amount of the claim is liquidated. If petitioner is not bound by the procedure established in Section 63a(7), the bankruptcy court is, as a practical matter, deprived of the flexibility that Congress, in Section 57(d), has provided to expedite resolution of unliquidated claims and avoid delay.

We think it notable that no one's research has disclosed a single case in bankruptcy or under Chapter XI that allows proof of any tort claim except as Section 63a(7) directs. Petitioner is wrong in saying that *Vass* v. *Conron Bros.*, 59 F. 2d 969 (C.A. 2), or *In re Progress Lektro Shave Corp.*, 35 F. Supp. 915 (D. Conn.) are such cases.

Vass involved a State court suit by a lessee of a cold storage plant for damages to the lessee's goods

resulting from the bankrupt lessor's failure to refrigerate the building. Although the suit contained an alternative count based on negligence, Judge Learned Hand found "this adds nothing." 59 F. 2d at 970. In ruling that the lessee's damages could be liquidated only in bankruptcy, and not in a State action, the court expressly relied on the trustee's "making himself liable on the covenants" of the lease. *Id.* at 971.

In re Progress Lektro Shave Corp. was a patent infringement suit, based on the trustee's public sale of shavers and parts subject to the claimant's patent. This case is therefore no different from others that allow a claim where the failure to do so would result in unjust enrichment of the bankrupt estate. *Cf. American A. & B. Coal Corp.* v. *Leonardo Arrivabene S.A.*, 280 F. 2d 119, 125–126 (C.A. 2); 3 *Collier on Bankruptcy* (Fourteenth ed. 1964), Para. 63.25. And although elements of tort inhere in actions for infringement, it is a mixed matter that has many of the conceptual elements similar to suits on implied contracts resulting from the provision of goods and services.[11]

This, then, would be the first case in which a court would have allowed a tort claim in bankruptcy where the procedure of Section 63a(7) was not fol-

[11] The dissenters below asserted that a third case, *In re Michigan Motor Specialties Co.*, 288 Fed. 377 (E.D. Mich.), was a bankruptcy case giving a first priority to a tort claim (R. 59 & n. 7). But that case, like *Progress Lektro Shave*, is a patent infringement case; the principal issue was whether bankruptcy terminated an exclusive license between the patentee and the bankrupt.

lowed. In *Schall* v. *Camors, supra,* this Court explicitly anticipated cases such as *Vass* "[w]here the tortious act constitutes at the same time a breach of contract," and cases such as *In re Progress Lektro Shave* "where * * * the tort-feasor obtains something of value for which an equivalent price ought to be paid, even if the tort as such be forgiven, there may be a provable claim *quasi ex contractu.*" 251 U.S. at 251. As this Court recognized, such cases raise "a different question" than one such as the present suit involving "a mere tort * * *." Resolution of the "different question" here must be premised on the congressional policies of Sections 63a(7) and 57(d) of the Bankruptcy Act. Only the weightiest considerations should justify a departure from those policies. No such consideration exists in this case, and no such departure is appropriate.

D. THE PERTINENT EQUITABLE CONSIDERATIONS REQUIRE THAT PETITIONER BE DENIED A FIRST PRIORITY

Petitioner's entire argument is premised on its assertion (Brief, p. 8) that "equitable considerations" require a grant of first priority to the victims of the Fretz Building fire. Petitioner—apart from its unjustified reliance on and erroneous interpretation of rules growing from "equity" receiverships (see pp. 30–34, *infra*)—has advanced no such consideration, and those that we perceive militate towards enforcement of the policies of Sections 62a(1), 63(a)(7), 64a(1), and 57(d).[12]

[12] Petitioner's assertion (Brief, p. 7) "that the bankruptcy court is a court of equity" is based on an unjustified truncation of the statutory language, which provides, in section 2, that

Such injuries as petitioner may have experienced in no way resulted from its relying on the existence of the arrangement, or acting in any manner different than it would have in the absence of the arrangement. Nothing essential to the conduct of the business during the arrangement can fairly be said to have caused the fire. Petitioner is in no different position than any other victim of an insolvent or judgment-proof tortfeasor. Had the fire preceded the arrangement, tort claims in bankruptcy unarguably would be limited to those who filed suit, and they would be only general creditors. Had the fire occurred during bankruptcy, Section 63a(7) would necessarily bar petitioner's claim.

Petitioner's position thus has in reality one and only one premise—the fortuitous fact that the Fretz Building fire occurred during a Chapter XI arrangement is said to entitle it to the greater dividend of the first priority. Nothing in "equity" or the Bankruptcy Act justifies placing petitioner in any better position than any other tort victim whom Congress has required to file suit before the bankruptcy as a prelude to presenting a claim in bankruptcy as a general creditor.

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district courts, as courts of bankruptcy, "are hereby invested * * * with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title * * *." We of course agree that the courts do and should seek to act equitably in filling the interstices of the Bankruptcy Act. But as this Court has repeatedly made clear, *e.g.*, *SEC* v. *U.S. Realty Co.*, 310 U.S. 434, 448, 455; *Williams* v. *U.S. Fidelity Co.*, 236 U.S. 549, 554–555, the congressional policies established in the Bankruptcy Act are the paramount consideration.

The cost of giving petitioner a first priority would be the total exclusion of creditors having a subordinate priority or no priority at all. For, if all negligence claims are proven in the fixed amount asserted, and granted the first priority, the tort claimants will receive approximately 20 cents on the dollar. No other claimant will receive anything. If, on the other hand, the tort claimants must share with, and had all proved their claims as general creditors, tort recoveries would have been reduced by at most a third—to 12 or 15 cents on the dollar. Wage claimants, the United States, and any others having subordinate priorities would be satisfied.

The general objectives of the Bankruptcy Act require the latter and not the former result. Congress has continually sought to limit priority claims to avoid exclusion of creditors having a subordinate priority or no priority (see pp. 10–11, *supra*). A prime objective of the Bankruptcy Act—the *equity* that it seeks—is to see that general creditors go away emptyhanded as seldom as possible. The result here, on the other hand, would be to exclude these creditors entirely. Wage claimants would also be entirely excluded. Granting petitioner a first priority would be inconsistent with the Congressional decision to grant subordinate priority status to the tax claims of the United States and the other governing bodies. These results would undoubtedly obtain wherever the priorities status of tort claimants was important enough to be litigated.

If considerations of essential fairness are to be the controlling element, we suggest that attention should

also be given to the problem of which persons can most fairly be expected to insure against losses such as petitioner experienced. It is unlikely that any property owner would seek, or any insurance company would grant, public liability insurance that would cover the combined losses asserted by those whose properties bordered on the Fretz Building and were consumed by a fire that spread in seldom experienced proportions. Insurance covering the spread of fire to adjoining premises is the exception and not the rule.[13] It is usual, however, for building owners to insure their premises against fire, and such insurance does not ordinarily depend upon whether the fire started on the insured's property or spread there from a neighbor's building. Therefore, it is those in the position of petitioner who could insure against these losses. The trustee, the debtor, or the creditors whom petitioner seeks to exclude could not reasonably be expected to obtain that insurance. To allow petitioner a first priority would, in such a circumstance, enlarge the loss of those who were unable to insure against it, while favoring those who could, and should, have mitigated their injury through obtaining what is the usual and ordinary fire insurance policy.[14]

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[13] For example, the standard fire insurance policy in force in Pennsylvania (See 40 Purdon's Pennsylvania Statutes Annotated (1966 Supp.), Sec. 636) provides insurance only for damage to the insured's property.

[14] Moreover, allowance of the first priority to petitioner's claim would contravene the reasonable expectations of statutory priority creditors. An arrangement may be proposed by general unsecured creditors; but it cannot be implemented without the

II. THE RULES OF "EQUITY" RECEIVERSHIPS DO NOT ENTITLE PETITIONER TO PREFERENCE OVER THE CLAIMS OF THE UNITED STATES

A. THE RULES APPLIED TO EQUITY, CHAPTER X, AND RAILROAD REORGANIZATIONS SHOULD NOT BE APPLIED IN ORDINARY BANKRUPTCIES AND ARRANGEMENTS.

Petitioner relies almost exclusively on cases and other authorities relating to equity receiverships or reorganizations of business corporations under Chapter X or railroads under Section 77 of the Bankruptcy Act. We do not dispute that tort claims arising during a receivership or reorganization period may be allowed in such cases, are not subject to the requirements of Section 63a(7), and have generally been given the priority status of general administrative expenses. But Congress has not made these rules part of the statutory scheme of ordinary bankruptcies and arrangements, and to adopt them would be inconsistent with the statuory scheme.

The Bankruptcy Act in its entirety provides a variety of procedures for the relief of insolvent debtors and the protection of their creditors. In gen-

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consent and forbearance of governments having tax claims and of statutory priority creditors. See Section 307 of the Act. That consent is premised on the predictability of the nature and extent of the administrative expenses that will be incurred and attain first priority during the arrangement. Were tort claims arising during administration given priority equal to the ordinary and expected commercial expenses of running the business during the arrangement, statutory priority creditors would be more likely to exercise their rights, Bankruptcy Act Sections 64a and 337(2), 11 U.S.C. 104(a) and 737, to insist that either they be paid in full before the arrangement proceeds or that the debtor be forced into bankruptcy.

eral, two distinct approaches have been used in defining administrative expenses and ordering the priority of claims in these various proceedings. One set of rules is those which have obtained in non-statutory equity receiverships. The other is those which Congress by statute created for use in ordinary bankrupticies.

Congress has expressly accepted many of the equity rules in Chapter X and Section 77. In contrast, Section 64a applies in ordinary bankruptcy, and Section 302 incorporates the rules of Section 64a for use in arrangements under Chapter XI. As the Second Circuit has reasoned in refusing to apply the equity rules in an arrangement (*In re Chicago Express, Inc.*, 332 F. 2d 276, 278):

> In § 77, relating to railroad reorganizations, subdivision (b) provides that "unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors" * * *. In Chapter X, relating to corporate reorganizations, Congress in § 102 ruled out the application of § 64, and provided in § 115 that the court "shall have and may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon it, exercise all the powers, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity of the

property of the debtor on the ground of insolvency or inability to meet its debts as they mature." In contrast, § 302 subjects priority questions in Chapter XI proceedings to the rules stated in § 64.

See also *In re Connecticut Motor Lines, Inc., supra; United States* v. *Anderson,* 334 F. 2d 111, 115–116 (C.A. 5); 3 *Collier on Bankruptcy,* par. 62.02, pp. 1396–1397; 6 *Collier on Bankruptcy,* par. 1.06, pp. 211–212, par. 3.17.

Furthermore, the recognition of tort claims in proceedings under Chapter X and Section 77 is not based solely on the statutory references to the rules of equity receiverships. Section 77 in fact gives tort claims a special statutory position in railroad reorganizations, because such claims so often arise in the ordinary course of operating a railroad. See Section 77(n) of the Act. There is in addition a need for recognizing tort claims arising during the administration of a reorganization that is not present in the ordinary bankruptcy or arrangement. By reorganization, the existence of one corporation is terminated; its assets and business are transmuted into a new corporate body. Some provision must be made for the new body's payment of all valid claims against the old. On the other hand, ordinary bankruptcy contemplates that the debtor will continue in existence and remain liable for whatever debts have not been discharged. If a Chapter XI arrangement is successful, the debtor of necessity continues in business and has become financially healthy and able to handle its obligations. And if the arrangement ends in bankruptcy, it is not different from any other bankruptcy.

Thus, the grant of a first priority through acceptance of petitioner's proferred authorities would be to apply the rules of equity receiverships to cases where Congress has provided otherwise, and where there is not present the basic factor that requires the making of some provision for every claim against estates to whose reorganization Congress has applied the "equity" rules.

B. EVEN THE RULES OF EQUITY RECEIVERSHIPS SHOULD NOT ENTITLE PETITIONER TO PRIORITY OVER THE TAX CLAIM OF THE UNITED STATES

Even if the rules of equity receiverships were to be applied here, to the exclusion of those governing bankruptcies, it would not follow that petitioner's claim must have the first priority claimed. In such receiverships the courts remain free to give tort and other claimants such priority as seems just and reasonable in the circumstances. For example, in *Piedmont Corp.* v. *Gainesville & N.W.R. Co.*, 30 F. 2d 525, 530 (N.D. Ga.), an equity receivership case, it was held that various court costs, expenses of sale, the compensation and expenses of officers of the court, including receivers and attorneys, and other necessary costs had priority over "[o]ther debts of the receivership * * * including tort liabilities," which, in turn, were given priority over a mortgage. See also *Underhay, supra*, p. 96.

The nature of the United States claim here, and the importance Congress has attached to it, favor preferring it over petitioner's claim, even if the "equity" rules were to be the basis of decision in this case. In reorganizations, see section 199, 271, and

77(e) of the Act, and arrangements, see sections 337(2) and 397, the United States has the right to insist on cash payment of its tax claims before the debtor secures relief under the Bankruptcy Act. Indeed the effect of Sections 77(e) and 199 is to give all claims of the United States priority in a reorganization over all claims of any other creditor. Thus a reorganization must provide cash payment in full to the United States, if the Government so insists. See *United States* v. *Anderson, supra,* at p. 116; 6A Colliers, *supra,* par. 9.10, at p. 215, par. 9.17, pp. 269–270.

To grant petitioner a priority ahead of the United States would ignore these qualifications that Congress has placed on the "equity" rules petitioner invokes. If its reliance on these authorities is to be accepted, the aspects of the rules governing reorganizations that favor the United States should also be applied in this case.[15]

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[15] There is no merit to petitioner's contention that denial of first priority status would violate the due process clause of the Fifth Amendment, and this would be true even if petitioner were correct in its claim that it could not have qualified as a general creditor. Not all claims in an insolvency situation can be satisfied in full. Congress in the bankruptcy statutes necessarily determined the provability and priority of claims against the estate in the light of all relevant public policy and equitable considerations. Nothing in the Constitution forbids the congressional decision to continue, with the limited exceptions provided in Section 63a, the traditional rule which forbids either payment or discharge of tort claims in bankruptcy. See *Kuehner* v. *Irving Trust Co.*, 299 U.S. 445; *Wright* v. *Union Central Ins. Co.*, 304 U.S. 502; cf. *Goldblatt* v. *Hempstead*, 369 U.S. 590.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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JANUARY, 1968.

APPENDIX

Bankruptcy Act. c. 541, 30 Stat. 544 [as amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840]:

Sec. 62 [As amended by Sec. 11, Act of June 28, 1946, c. 512, 60 Stat. 323, and Sec. 17, Act of July 7, 1952, c. 579, 66 Stat. 420], *Expenses of administering estates; unauthorized sharing of fees; withholding allowances.*—

a. (1) The actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates shall, except where other provisions are made for their payment, be reported in detail under oath, and examined and approved or disapproved by the court. If approved, they shall be paid or allowed out of the estates in which they were incurred.

* * * * *

(11 U.S.C. 1958 ed., Sec. 102.)

Sec. 63. *Debts Which May be Proved.*—a. Debts of the bankrupt may be proved and allowed against his estate which are founded upon * * * (7) the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy; * * *.

* * * * *

(11 U.S.C. 1958 ed., Sec. 103.)

Sec. 64 [As amended by Sec. 19, Act of July 7, 1952, *supra;* Sec. 1, Act of July 30, 1956, c. 784, 70 Stat. 725; Sec. 3, Act of July 28, 1959, P.L. 86–110, 73 Stat. 260; Sec. 8, Act of September 25, 1962, P.L. 87–681, 76 Stat. 571]. *Debts Which Have Priority.*—

a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases: where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expense of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of title 18 of the United States Code, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy

be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this Act, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further,* That, in

case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy. (11 U.S.C. 1958 ed., Supp. V, Sec. 104.)

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SUPREME COURT, U. S.

No. 127

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IN THE

Supreme Court of the United States

October Term, 1967

READING COMPANY, *Petitioner*

v.

FRANCIS SHUNK BROWN, 3RD, *Trustee of the Estate of* I. J. KNIGHT REALTY CORP., *Bankrupt, Respondent*

and

UNITED STATES OF AMERICA, *Respondent*

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

INTRODUCTION

The issue in this case is whether damages arising from the negligence of a receiver operating the business of a debtor under Chapter XI of the Bankruptcy Act are expenses of administration under Section 64a(1) of the Act, payable out of the assets of the estate. Both the Government and the trustee endeavor to becloud this issue by referring to pre-bankruptcy torts and by discussing what other rights claimants have or had if their claims are not expenses of administration. No pre-bankruptcy torts are involved and petitioner submits that the other arguments of the Government and trustee are without substance.

I. THE CLAIMS HERE INVOLVED DO NOT COME WITHIN THE PROVISIONS OF SECTION 63 OF THE BANKRUPTCY ACT.

Both the Government and the trustee treat the fire loss claims as if they were provable under Section 63 of the Bankruptcy Act. The Government asserts that the claims would have been provable under Section 63a(7) of the Act if suit had been brought thereon prior to the bankruptcy (Brief, p. 5). The trustee argues that, if the claims are not provable, they are not discharged under Section 17 of the Bankruptcy Act (11 U.S.C. §35) (Brief, p. 12). Both contentions are based upon the fallacious assumption that the claims are debts of the bankrupt within the meaning of Section 63. The claims here involved are not debts of the bankrupt. They are made against the estate for damages resulting from a tort of the receiver operating the business (R. 21). This distinction is well expressed in 3 *Collier on Bankruptcy*, Section 63.03, p. 1764 as follows:

> "The express language of §63, '*Debts of the bankrupt* may be proved and allowed', clearly limits the class of provable claims to those which can be asserted against the debtor in bankruptcy."

In a footnote to this statement, *Collier* states (pp. 1764-65):

> "This, of course, involves observing the difference between provable debts and those claims arising after bankruptcy which may be termed expenses of administration. (Citing earlier section.) Such claims are not obligations of the debtor in bankruptcy, but are rather claims against the assets of his estate in the hands of the court and its officers. Thus taxes accruing as a consequence of the operation of a bankrupt corporation's business by a bankruptcy receiver are not provable debts owing by the corporation itself but are obligations of the receivership to be classed as administrative expenditures." (Citing *McColgan v. Maier Brewing Co.*, 134 F.2d 385, (9 Cir. 1943) cert. den. 320 U.S. 737, and other authorities.)

Further answer to the Government's contention is to be found in Section 378(2) of the Bankruptcy Act 11 U.S.C. 778(2) (Appendix, p. 9) which provides that when a bankruptcy follows an arrangement, the bankruptcy "proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition of adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition [for the arrangement] was filed. . . ." In other words, the legal effect is to date the bankruptcy from the date of the original Chapter XI petition, which was prior to the fire (R. 21).

II. The Claims Here Involved Are Just as Much Expenses of Administration as Are Taxes, Interest Thereon and Penalties.

The Government states (Brief, p. 14) that when, as in a Chapter XI proceeding, a receiver, trustee or debtor continues to operate an insolvent business "the category of administrative expenses is enlarged to include at least

some expenses that are 'necessary' in the sense that without the goods or services which they represent the business would be unable to operate." It argues that there is no justification in extending this treatment to petitioner's tort claims. In *Boteler v. Ingels*, 308 U.S. 57, 60 (1939), this Court held that a trustee in bankruptcy is liable for penalties imposed for nonpayment of state vehicle license fees since the "fees and penalties in issue were incurred by the trustee in operating the bankrupt business. . . ." Certainly, if the Government is correct here in its attempted rationalization of expenses of administration as excluding petitioner's tort claims, such reasoning would exclude penalties for nonpayment of state licenses as well.

This Court also held that federal taxes incurred during the period when a business is being operated by a debtor in a Chapter XI arrangement are entitled to first priority as administrative expenses, even though Congress specifically gave taxes a fourth priority under Section 64a(4) of the Bankruptcy Act. *Nicholas v. United States*, 384 U.S. 678 (1966). At 384 U.S. 687-88 the Court stated:

> "Taxes incurred in the pre-arrangement period must be content with a fourth priority under Section 64a(4) of the Bankruptcy Act. On the other hand, *taxes incurred during the arrangement period are expenses of the Chapter XI proceedings and are therefore technically a part of the first priority under Section 64(1).*" (Emphasis supplied.)

In the same case this Court ruled that interest on the foregoing Chapter XI taxes, if it had accrued during the arrangement period, would also have been an expense of administration (384 U.S. 682-90).

In both the *Boteler* and the *Nicholas* cases this Court referred to the provisions of 28 U.S.C. §960, where Congress directed that federal receivers shall be taxed as if they were conducting a private business. 308 U.S. at 60-61; 384 U.S. at 690. The immediately preceding section, 28

U.S.C. §959(a) and (b) (Petitioner's brief, p. 27) provides that federal receivers conducting a business shall do so according to the requirements of the laws of the state in which they are operating, in the same manner as a private owner or possessor. This is a clear mandate of Congress that the trustee is here liable for damages resulting from his torts the same as any other person conducting a business.[1]

The Department of Justice has repeatedly cited *Collier on Bankruptcy* in its brief (see e.g. pp. 10, 11, 14, 15, 22, 25, 31, 32), but omitted citing the section which directly bears on the issue here presented. At 3 *Collier on Bankrupty*, §62.15 (p. 1540) it is stated:

> "Among other expenses incident to conducting a business and therefore allowable as administrative expenditure may be royalties for a "patented process of manufacture, fees of detectives hired to discover persons involved in theft of assets, *payments on claims for personal injuries inflicted in the operation of a business*, rent, insurance, commissions, cost of raw material or merchandise purchased for manufacturing or resale *and any other expense ordinarily attendant upon active participation in commercial or industrial life.*" (Emphasis supplied.)

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[1] The Government in its brief (pp. 5, 17-18) now reverses its position below and concedes that there might be circumstances under which tort claims arising during an arrangement might be entitled to a first priority as "necessary" expenses of administration, such as, it explains, torts arising from an activity which was an integral and essential element of the continuation of the business. Congress did not make any such distinction. In any event, the fire which caused the losses here arose in connection with an activity which was an integral and essential element of the continuation of the business, namely maintenance of the building which was being operated for the benefit of the receiver's tenants (R. 6-12, 21). Furthermore, it is difficult to imagine any situation where, under the prevailing law of agency and torts, a trustee would not be liable for damages arising from any activity involved in carrying out the business because any such activity would be deemed "integral and essential."

III. Respondents' Contentions Are Not Supported by the Cited Amendments to the Bankruptcy Act.

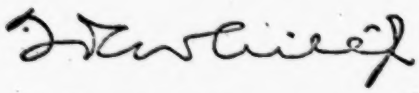
In support of its argument that Congress has shown a purpose to limit the priorities accorded in Section 64, the Government asserts (Brief, p. 10) that Congress has changed those priority provisions on several occasions, and in "each significant instance the result has been to limit, and not to expand, the category of claims accorded priority; . . ." Although petitioner does not consider the point which the Government is endeavoring to make of much help to the Court in determining the meaning of "costs and expenses of administration," it takes issue with the Government's summarization of the legislative changes. Numerous significant changes actually enlarged the priorities. See 3 *Collier on Bankruptcy*, §64.01, pp. 2048-62.

Both the Government (Brief, p. 31) and the trustee (Brief, p. 13), in support of their contention that Congress did not intend to include tort claims as expenses of administration under Section 64a(1), argue that, when Congress intended to include tort claims as expenses of administration in bankruptcy proceedings it knew how to do so, citing Section 77(n) of the Bankruptcy Act 11 U.S.C. §205(n). This argument overlooks the fact that the intent of Section 77(n) was to give a priority status to tort claims which had not theretofore been recognized as expenses of administration in railroad equity receiverships, namely claims for personal injuries to, or death of, *employees* arising *prior* to the receivership. See e.g., *In re: Hudson and Manhattan Railroad Company*, 178 F. Supp. 103 (S.D. N.Y. 1959), aff'd, 273 F. 2d 707 (2d Cir. 1960). *Employee* injury and death claims arising *during* the receivership had always been given priority as expenses of operation of the business. See 5 *Collier on Bankruptcy*, §77.21, fn. 24 and 25, pp. 571-73.

CONCLUSION

The judgment of the court below should be reversed.

Respectfully submitted,



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Attorneys for Petitioner

January 22, 1968

STATE OF PENNSYLVANIA
COUNTY OF PHILADELPHIA ss.

I, THOMAS RAEBURN WHITE, JR., counsel for the petitioner herein, and attorney of record for petitioner in the courts below, state that on the 22nd day of January, 1968, I served five copies of the foregoing Reply Brief for Petitioner on the respondents, as required by Rule 33, by personally mailing said copies hereof to Messrs. Dechert, Price and Rhoads, in care of their office, 1600 Three Penn Center Plaza, Philadelphia, Pennsylvania 19102, to the Solicitor General, Department of Justice, Washington 25, D. C., and to Richard M. Roberts, Assistant Attorney General, Department of Justice, Washington, D. C. 20530, the attorney who argued the case for the United States in the courts below.

THOMAS RAEBURN WHITE, JR.
Member of the Bar of the United States Supreme Court

APPENDIX

"Sec. 378. Upon the entry of an order directing that bankruptcy be proceeded with. . . .

(2) in the case of a petition filed under section 322 of this Act, the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed; and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed as provided in section 44 of this Act."

SUPREME COURT OF THE UNITED STATES

No. 127.—October Term, 1967.

Reading Company, Petitioner, v. Francis Shunk Brown, 3d, etc., et al.	On Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

[June 3, 1968.]

Mr. Justice Harlan delivered the opinion of the Court.

On November 16, 1962, I. J. Knight Realty Corporation filed a petition for an arrangement under Chapter XI of the Bankruptcy Act, 11 U. S. C. §§ 701–799. The same day, the District Court appointed a receiver, Francis Shunk Brown, a respondent here. The receiver was authorized to conduct the debtor's business, which consisted principally of leasing the debtor's only significant asset, an eight-story industrial structure located in Philadelphia.

On January 1, 1963, the building was totally destroyed by a fire which spread to adjoining premises and destroyed real and personal property of petitioner Reading Company and others. On April 3, 1963, petitioner filed a claim for $559,730.83 in the arrangement, based on the asserted negligence of the receiver. It was styled a claim for "administrative expenses" of the arrangement. Other fire loss claimants filed 146 additional claims of a similar nature. The total of all such claims was in excess of $3,500,000, substantially more than the total assets of the debtor.

On May 14, 1963, Knight Realty was voluntarily adjudicated a bankrupt and respondent receiver was subsequently elected trustee in bankruptcy. The claims of petitioner and others thus became claims for administra-

tion expenses in bankruptcy which are given first priority under § 64a (1) of the Bankruptcy Act, 11 U. S. C. § 104 (a)(1).[1] The trustee moved to expunge the claims on the ground that they were not for expenses of administration. It was agreed that the decision whether petitioner's claim is provable as an expense of administration would establish the status of the other 146 claims. It was further agreed that, for purposes of deciding whether the claim is provable, it would be assumed that the damage to petitioner's property resulted from the negligence of the receiver and a workman he employed.[2] The United States, holding a claim for unpaid prearrangement taxes admittedly superior to the claims of general creditors and inferior to claims for administration expenses, entered the case on the side of the trustee.

The referee disallowed the claim for administration expenses. He also ruled that petitioner's claim was not provable as a general claim against the estate, a ruling challenged by neither side.[3] On petition for review, the

[1] Section 302 of the Act, 11 U. S. C. § 702, provides in part as follows:

"The provisions of chapters 1–7, inclusive, of this title shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, [XI] apply in proceedings under this chapter."

Section 64a (1), a part of Chapter VII and hence applicable to Chapter XI arrangements by virtue of § 302, itself provides that where, as here, ordinary bankruptcy ensues upon a proceeding under another chapter,

"the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration . . . incurred in the superseded proceeding . . . ."

We deal here, therefore, with a claim that will in any event be subordinate to administration expenses of the bankruptcy proper.

[2] Thus the merits of negligence claims have not been adjudicated, and, of course, we intimate no views upon them.

[3] See *infra*, p. 8.

referee was upheld by the District Court. On appeal, the Court of Appeals for the Third Circuit, sitting *en banc*, affirmed the decision of the District Court by a 4–3 vote. We granted certiorari, 389 U. S. 895, because the issue is important in the administration of the bankruptcy laws and is one of first impression in this Court. For reasons to follow, we reverse.

Section 64a of the Bankruptcy Act provides in part as follows:

> "The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition . . . ."

It is agreed that this section, applicable by its terms to straight bankruptcies, governs payment of administration expenses of Chapter XI arrangements. Furthermore, it is agreed that for the purpose of applying this section to arrangements, the words "subsequent to filing the petition" refer to the period subsequent to the *arrangement* petition,[4] and the words "preserving the estate" include the larger objective, common to arrangements, of operating the debtor's business with a view to rehabilitating it.[5]

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[4] This is explicitly provided in § 302.

[5] Compare 3 Collier, Bankruptcy ¶ 62.15:

"Section 2a (5) empowers the court to authorize the business of bankrupts to be conducted for a limited period by a marshal, receiver or trustee. Such continued operation of a business is in substance a means of preservation, namely as a going concern, sometimes with a view to rehabilitation . . . . Expenditure incurred by continued operation of a bankrupt's business will, therefore, follow the rules . . . as to expenditure in connection with preserva-

The question in this case is whether the negligence of a receiver administering an estate under a Chapter XI arrangement gives rise to an "actual and necessary" cost of operating the debtor's business. The Act does not define "actual and necessary," nor has any case directly in point been brought to our attention.[6] We must, therefore, look to the general purposes of § 64a, Chapter XI, and the Bankruptcy Act as a whole.

The trustee contends that the relevant statutory objectives are (1) to facilitate rehabilitation of insolvent businesses and (2) to preserve a maximum of assets for

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tion. The difference, if any, lies in the greater variety of types of expenses . . . ." (Footnotes omitted).

[6] The case that petitioner finds most closely in point is *Vass* v. *Conron Bros.*, 59 F. 2d 969. Vass was the receiver of certain bankrupts who had been dealers in cold meats and had leased space in their cold storage plant to Conron. Vass confirmed the lease, one of whose covenants provided that the lessor would maintain sufficient refrigeration; thereafter, Vass allegedly failed to refrigerate properly, damaging stored property of the lessee. The lessee then attempted to sue Vass in a state court, alleging breach of the covenant and negligence. Vass, however, obtained an injunction from the bankruptcy court against the state action; the Court of Appeals affirmed in an opinion by L. Hand.

The issue in *Vass* was whether the state action would conflict with the bankruptcy court's jurisdiction over the estate. In ruling that the action could not be maintained, Judge Hand concluded *inter alia*, that the action did *not* fall within the federal statutory permission for actions based on any liability arising out of "any act or transaction" of the trustee "in carrying on the business connected with" the property entrusted to him. Judge Hand concluded, on special facts, that the trustee in confirming the lease was merely holding matters *in statu quo*, not continuing the business. Consequently, he said that "the liquidation of the lessee's resulting damages was as much a part of the usual administration in bankruptcy, as that of the pay of accountants, custodians or other assistants." 59 F. 2d, at 971. In context, the language just quoted is of little assistance in the present case.

distribution among the general creditors should the arrangement fail. He therefore argues that first priority as "necessary" expenses should be given only to those expenditures without which the insolvent business could not be carried on. For example, the trustee would allow first priority to contracts entered into by the receiver because suppliers, employees, landlords, and the like would not enter into dealings with a debtor in possession or a receiver of an insolvent business unless priority is allowed. The trustee would exclude all negligence claims, on the theory that first priority for them is not necessary to encourage third parties to deal with an insolvent business, that first priority would reduce the amount available for the general creditors, and that first priority would discourage general creditors from accepting arrangements.

In our view the trustee has overlooked one important, and here decisive, statutory objective: fairness to all persons having claims against an insolvent. Petitioner suffered grave financial injury from what is here agreed to have been the negligence of the receiver and a workman. It is conceded that, in principle, petitioner has a right to recover for that injury from their "employer," the business under arrangement, upon the rule of *respondeat superior*.[7] Respondents contend, however, that

[7] 28 U. S. C. § 959 (b) provides as follows:

"A trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof."

This provision of course establishes only the principle of liability under state tort and agency law, and does not decide from whom

petitioner is in no different position from anyone else injured by a person with scant assets: his right to recover exists in theory but is not enforceable in practice.

That, however, is not an adequate description of petitioner's position. At the moment when an arrangement is sought, the debtor is insolvent. His existing creditors hope that by partial or complete postponement of their claims they will, through successful rehabilitation, eventually recover from the debtor either in full or in larger proportion than they would in immediate bankruptcy. Hence the present petitioner did not merely suffer injury at the hands of an insolvent business: it had an insolvent business thrust upon it by operation of law. That business will, in any event, be unable to pay its fire debts in full. But the question is whether the fire claimants should be subordinated to, should share equally with, or should collect ahead of those creditors for whose benefit the continued operation of the business (which unfortunately led to a fire instead of the hoped-for rehabilitation) was allowed.

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or with what priority tort claims may be collected. In *McNulta* v. *Lochridge*, 141 U. S. 327, 332, this Court had occasion to note that "[a]ctions against the receiver are in law actions against the receivership, or the funds in the hands of the receiver, and his contracts, misfeasances, negligences and liabilities are official and not personal, and judgments against him as receiver are payable only from the funds in his hands."

This statement of course means only that torts of a receiver are in principle compensable out of the assets of the estate in receivership and, again, does not indicate whether such claims shall be paid prior to, equally with, or after other claims against the receivership.

We do not here reach, and do not mean to reaffirm the implication of *McNulta* that an action against the receiver personally, or against the debtor after termination of the receivership, would never lie under any circumstances. As to such questions, the statement of *McNulta* is dictum.

Recognizing that petitioner ought to have some means of asserting his claim against the business whose operation resulted in the fire, respondents have suggested various theories as alternatives to "administration expense" treatment. None of these has case support, and all seem to us unsatisfactory.

Several need not be pursued in detail. The trustee contends that if the present claims are not provable in bankruptcy they would survive as claims against the shell. He also suggests that petitioner may be able to recover from the receiver personally, or out of such bond as he posted. Without deciding whether these possible avenues are indeed open,[8] we merely note that they do not serve the present purpose. The "master," liable for the negligence of the "servant" in this case was the business operating under a Chapter XI arrangement for the benefit of creditors and with the hope of rehabilitation. That benefit and that rehabilitation are worthy objectives. But it would be inconsistent both with the principle of *respondeat superior* and with the rule of fairness in bankruptcy to seek these objectives at the cost of excluding tort creditors of the arrangement from its assets, or totally subordinating the claims of those on whom the arrangement is imposed to the claims of those for whose benefit it is instituted.

The United States, as a respondent, suggests instead that tort claims arising during an arrangement are, if properly preserved, provable general claims in any subsequent bankruptcy under § 63a of the Act, 11 U. S. C. § 103 (a). That section reads as follows:

> "Debts of the bankrupt may be proved and allowed against his estate which are founded upon . . . (7) the right to recover damages in any action for

[8] See n. 7, *supra*.

> negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy . . . ."

It is agreed by all parties that this section will not avail the present petitioner who, it appears, did not file suit on its claim prior to the bankruptcy proper. This, the United States argues, is its own fault: it could have filed suit after the tort, during the arrangement, and before the petition in bankruptcy, and thus preserved its claim.

This was not the view of the District Court. Section 302 of the Act, the section which provides that Chapters I to VII of the Act (including §§ 63 and 64) shall be applicable to arrangements under Chapter XI as well as straight bankruptcies, contains the following provision:

> "For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 722 of this title [§ 322 of the Act, 11 U. S. C. § 722, which provides for filing original petitions for arrangements] . . . ."

Section 378 (2) of the Act, 11 U. S. C. § 778 (2), dealing with procedure when bankruptcy ensues upon an arrangement, povides that

> "in the case of a petition filed under section 722 of this title, the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter [*i. e.*, the petition for an arrangement] was filed . . . ."

The effect of these two sections is that, whether or not an arrangement is superseded by bankruptcy, for purposes of applying § 63 to arrangements the date of the arrangement petition is deemed to be the date of a petition in bankruptcy.

From this fact, the District Court concluded, and petitioner now argues, that a person negligently injured during the course of an arrangement could never have a provable general claim under § 63a. For that section requires that suit be filed before the filing of the petition in bankruptcy, and, when the section is applied to an arrangement, the date of the filing of the petition in bankruptcy is deemed to be the date of the filing of the arrangement petition.

In response, the United States notes that § 378 (2) is qualified by the words "so far as possible." The Government therefore suggests a holding that it is not "possible" to treat the date of the arrangement petition as the critical date in a case such as the present, because that point in time antedates the tort. On that theory, it is suggested that, for present purposes, § 63a's reference to the date of filing the bankruptcy petition be taken to refer to the date of the petition in bankruptcy proper.

We do not find this an acceptable alternative. The only thing that renders it not "possible" to follow the statutory scheme and meld the arrangement into the bankruptcy is the Government's insistence that petitioner's claim must be held to have been provable under § 63a if only petitioner had taken the proper steps. There is nothing "impossible" about construing the sections here involved to mean what they say: a tort claim arising during an arrangement, like a tort claim arising during a bankruptcy proceeding proper, is not provable as a general claim in the bankruptcy.

There are additional reasons for reading the sections literally in this case. In the first place, the United States' suggestion will not work where bankruptcy does not ensue upon the arrangement, for then there is no later date that can be used as the cutoff for 63a (7) claims. In that case, it would be necessary either to hold that a tort claim arising during an arrangement is a prov-

able general claim if bankruptcy ensues but is not a provable general claim in the arrangement itself, or to hold that there is no time limit on filing suit so long as the arrangement remains an arrangement. Nothing in the qualifying language of § 378 (2) grants permission to read the time limitation out of § 63a (7) of the Act.

An even greater difficulty is presented by the fact that § 63a refers to provable debts of the *bankrupt*, and distinguishes the bankrupt from his *estate*. Section 302 provides that in applying § 63a to arrangements, the word "bankrupts" shall be deemed to relate also to "debtors." Thus the natural reading of § 63a, when applied to arrangements as if they were bankruptcies, is that in order to be provable under § 63a (7) a tort claim must be a claim against the debtor and not against the estate in a Chapter XI arrangement. Respondents might argue this question as they do the time limitation: that it would be preferable to deem the words "debts of the bankrupt" to mean "debts of the debtor or of his estate arising up to the time of bankruptcy proper." This argument is open, however, to the same objections as the argument on time limitations: it is a strained reading of the statute which makes no allowance for the occasions when straight bankruptcy does not ensue.

In any event, we see no reason to indulge in a strained construction of the relevant provisions, for we are persuaded that it is theoretically sounder, as well as linguistically more comfortable, to treat tort claims arising during an arrangement as actual and necessary expenses of the arrangement rather than debts of the bankrupt. In the first place, in considering whether those injured by the operation of the business during an arrangement should share equally with, or recover ahead of, those for whose benefit the business is carried on, the latter seems more natural and just. Existing creditors are, to

be sure, in a dilemma not of their own making, but there is no obvious reason why they should be allowed to attempt to escape that dilemma at the risk of imposing it on others equally innocent.

More directly in point is the possibility of insurance. An arrangement may provide for suitable coverage, and the court below recognized that the cost of insurance against tort claims arising during an arrangement is an administrative expense payable in full under § 64a (1) before dividends to general creditors.[9] It is of course obvious that proper insurance premiums must be given priority, else insurance could not be obtained; and if a receiver or debtor in possession is to be encouraged to obtain insurance in adequate amounts, the claims against which insurance is obtained should be potentially payable in full. In the present case, it is argued, the fire was of such incredible magnitude that adequate insurance probably could not have been obtained and in any event would have been foolish; this may be true, as it is also true that allowance of a first priority to the fire claimants here will still only mean recovery by them of a fraction of their damages. In the usual case where damages are within insurable limits, however, the rule of full recovery for torts is demonstrably sounder.

Although there appear to be no cases dealing with tort claims arising during Chapter XI proceedings, decisions in analogous cases suggest that "actual and necessary costs" should include costs ordinarily incident to operation of a business, and not be limited to costs without which rehabilitation would be impossible. It has long been the rule of equity receiverships that torts of the receivership create claims against the receivership itself;[10] in those cases the statutory limitation to "actual

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[9] 370 F. 2d 624, 628.

[10] *E. g., Texas and Pacific Railway* v. *Bloom*, 164 U. S. 636; *Bereth* v. *Sparks*, 51 F. 2d 441; § 77 (n), 11 U. S. C. § 205 (n), according

and necessary costs" is not involved, but the explicit recognition extended to tort claims in those cases weighs heavily in favor of considering them within the general category of costs and expenses.

In some cases arising under Chapter XI it has been recognized that "actual and necessary costs" are not limited to those claims which the business must be able to pay in full if it is to be able to deal at all. For example, state and federal taxes accruing during a receivership have been held to be actual and necessary costs of an arrangement.[11] The United States, recognizing and supporting these holdings, agrees with petitioner that costs that form "an integral and essential element of the continuation of the business" are necessary expenses even though priority is not necessary *to* the continuation of the business. Thus the Government suggests that "an injury to a member of the public—a business invitee—who was injured while on the business premises during an arrangement would present a completely different problem [i. e., could qualify for first priority]" although it is not suggested

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particular recognition to the tort claims of railroad employees, does not, as the dissent suggests, mean that other tort claims are not chargeable against a receivership itself. Rather, as the United States concedes, "tort claims arising during a receivership or reorganization period . . . have generally been given the priority status of general administrative expenses."

[11] *E. g., Nicholas* v. *United States*, 384 U. S. 678. At pages 687–688 we stated:

"Taxes incurred in the pre-arrangement period must be content with a fourth priority under § 64a (4) of the Bankruptcy Act. On the other hand, taxes incurred during the arrangement period are expenses of Chapter XI proceedings and are therefore technically a part of the first priority under § 64a (1)."

The Court also ruled that interest accruing on such claims during the arrangement period would also fall within § 64a (1). *Ibid.* See also *Boteler* v. *Ingels*, 308 U. S. 57.

that priority is needed to encourage invitees to enter the premises.

The United States argues, however, that each tort claim "must be analysed in its own context." Apart from the fact that it has been assumed throughout this case that all 147 claimants were on an equal footing and it is not very helpful to suggest here for the first time a rule by which lessees, invitees, and neighbors have different rights, we perceive no distinction. No principle of tort law of which we are aware offers guidance for distinguishing, within the class of torts committed by receivers while acting in furtherance of the business, between those "integral" to the business and those that are not.[12]

We hold that damages resulting from the negligence of a receiver acting within the scope of his authority as receiver give rise to "actual and necessary costs" of a Chapter XI arrangement.

The judgment of the Court of Appeals is reversed, and the case remanded for further proceedings consistent with this opinion.

It is so ordered.

MR. JUSTICE MARSHALL took no part in the consideration or decision of this case.

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[12] Compare 3 Collier, Bankruptcy § 62.15:

"Among other expenses incident to conducting a business and therefore allowable as administrative expenditure may be . . . payments on claims for personal injuries inflicted in the operation of a business, rent, insurance, commissions, cost of raw material or merchandise purchased for manufacturing or resale and any other expense ordinarily attendant upon active participation in commercial or industrial life." (Footnotes omitted.)

SUPREME COURT OF THE UNITED STATES

No. 127.—October Term, 1967.

Reading Company, Petitioner, v. Francis Shunk Brown, 3d, etc., et al.	On Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

[June 3, 1968.]

Mr. Chief Justice Warren, with whom Mr. Justice Douglas joins, dissenting.

In my opinion, the Court has misinterpreted the term "costs and expenses of administration" as intended by § 64a (1) and, by deviating from the natural meaning of those words, has given the administrative cost priority an unwarranted application. The effect of the holding in this case is that the negligence of a workman may completely wipe out the claims of all other classes of public and private creditors. I do not believe Congress intended to accord tort claimants such a preference. Accordingly, I would affirm the judment below.

On other occasions, this Court has observed that "[t]he theme of the Bankruptcy Act is 'equality of distribution' . . . ; and if one claimant is to be preferred over the others, the purpose should be clear from the statute." *Nathanson* v. *NLRB*, 344 U. S. 25, 29 (1952); see *Sampsell* v. *Imperial Paper Corp.*, 313 U. S. 215, 219 (1941). More particularly, the Act expressly directs that eligible negligence claims are to share *equally* with the unsecured claims in a pro rata distribution of the debtor's non-exempt assets. Bankruptcy Act §§ 63a (7), 65a, 11 U. S. C. §§ 103 (a)(7), 65 (a). Departing from this statutory scheme, the Court today singles out one class of tort claims for special treatment. After today's decision, the status of a tort claimant depends entirely upon

whether he is fortunate enough to have been injured after rather than before a receiver has been appointed. And if the claimant is in the select class, he may be permitted to exhaust the estate to the exclusion of the general creditors as well as of the wage claims and government tax claims for which Congress has shown an unmistakable preference.[1] In my view, this result frustrates rather than serves the underlying purposes of a Chapter XI proceeding, and I would not reach it without a clear indication that Congress so intended.

Congress enacted Chapter XI as an alternative to straight bankruptcy for individuals and small businesses which might be successfully rehabilitated instead of being subjected to economically wasteful liquidation. The success of a Chapter XI proceeding depends largely on two factors: first, whether creditors will take the chance of permitting an arrangement; second, whether other businesses will continue to deal with the distressed business. With respect to the first of these considerations, today's decision will undoubtedly discourage creditors from permitting arrangements, because it subjects them to unpredictable and probably uninsurable tort liability. I do not believe the statutory language requires such an interpretation. I would construe § 64a (1) with reference to the second consideration mentioned above. In my opinion, the Court would reach a result more in line with congressional intent and the Bankruptcy Act generally by regarding as administrative costs only those costs required for a smooth and successful arrangement. Accordingly, the administrative cost priority should be

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[1] Certain wage claims and government taxes obtain second and fourth priorities respectively under the second and fourth subdivisions of § 64a, 11 U. S. C. §§ 104 (a)(2), 104 (a)(4). The government tax claims in this case, nearly all of which will be excluded from sharing in the estate under today's decision, amount to approximately $245,000.

viewed as a guaranty to the receiver and those who deal with or are employed by him that they will be paid for their goods and services. Any broader interpretation will discourage creditors from permitting use of the rehabilitative machinery of Chapter XI and tend to force distressed businesses into straight bankruptcy.

It is equitable, the Court believes, that the general creditors (and wage and tax claimants) bear the loss in this case because they have "thrust" an insolvent business upon petitioner for their own benefit. I respectfully submit that this is a most unfair characterization of arrangements. An economically distressed businessman seeks an arrangement for his own and not for his creditors' benefit.[2] Of course the creditors will benefit if the arrangement is successful, just as they would have benefited if the businessman had been successful without resorting to an arrangement. But a business in arrangement is no more thrust on the public than is any other business enterprise which is conducted for the mutual prosperity of the owners, the wage-earners and the creditors. Realistically, the only difference is that a business administered under Chapter XI has not been prosperous. If the arrangement is successful, the owners, wage-earners and creditors will all benefit; if it is not, they will all be injured. Thus, I would not distinguish in this case between petitioner and the other general creditors, none of whom was responsible for the catastrophe for which all of them must sustain some loss. Instead, in deciding this case, I would adhere to the Act's basic theme of equality of distribution.

The Court states that its decision will encourage Chapter XI receivers to obtain "adequate" insurance. The Court fairly well concedes, however, that in this case

[2] Unlike straight bankruptcy, only the debtor himself may file a petition for an arrangement under Chapter XI. Bankruptcy Act §§ 321, 322, 11 U. S. C. §§ 721, 722; 8 Collier, Bankruptcy ¶ 4.02 [1].

"adequate" insurance "probably could not have been obtained and in any event would have been foolish." In other words, so far as this Court knows the insurance taken out by the receiver in this case was in fact "adequate," in the sense that no reasonable receiver could or should obtain fire insurance in the amount of $3,500,000 on the assumption that his workman might accidentally cause a fire of the proportions which occurred here. Moreover, quite apart from the case at bar, there is absolutely no indication that today's decision is needed to encourage receivers to obtain insurance.[3] I see no basis in the Act or in sound policy for a ruling that the creditors of an estate under a Chapter XI arrangement become involuntary insurers against a liability which probably would not and should not be insurable by more traditional means.

The Court also relies, in my opinion mistakenly, upon analogies to equity receiverships. In reorganizations under Chapter X[4] and § 77,[5] Congress has directed the courts to apply the rules of priority developed in equity.[6] However, arrangements under Chapter XI are governed strictly by the statutory priorities fixed by § 64a. These statutory priorities differ in many respects from those applicable to equity receiverships,[7] and they have been

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[3] In fact, the absence of any other adjudicated case on the question here presented is a strong indication that the receiver's insurance is usually perfectly adequate.

[4] 11 U. S. C. §§ 501–676.

[5] 11 U. S. C. § 205.

[6] Bankruptcy Act §§ 77b, 115, 11 U. S. C. §§ 205 (b), 515; see *In re Chicago Express, Inc.*, 332 F. 2d 276, 278 (C. A. 2d Cir. 1964). Section 102 of the Act (11 U. S. C. § 502), which is applicable to corporate reorganizations, specifically provides that § 64 "shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with . . ."

[7] To take but two examples, government tax claims obtain a higher priority in equity receiverships and under Chapter X than

amended repeatedly to narrow the class of claimants which may participate ahead of the general creditors.[8] Furthermore, even in the case of § 77 reorganizations where the priorities developed in equity are controlling, Congress has specifically provided for one exception to the rule that tort claimants are to be treated as general creditors. Bankruptcy Act § 77n, 11 U. S. C. § 205 (n). That exception is in favor of a narrowly defined class of claimants. Congress has not expressly provided a similar exception to cover petitioner's tort claim, and I would not infer one.

Finally, the Court concludes, for two reasons, that it is "linguistically more comfortable" to treat petitioner's claim as an administrative cost rather than as a negligence claim which could have been proven under § 63a (7). First, § 63a refers to provable claims against the debtor and not against his estate. Second, §§ 63a (7) and 302 require that an action be commenced on the claim before the filing of the arrangement petition, and allowing claims like petitioner's would in effect toll the time limitation imposed by these sections. With respect to the first of the Court's reasons, I find no statutory or practical basis for distinguishing between the debtor and his estate in this case. Had the arrangement been successful, the debtor would have been liable for any damages occasioned during the administration under the line of cases relied upon by the Court. *Texas & Pacific Railway* v. *Bloom*, 164 U. S. 636 (1897). The

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they do under § 64a, see Bankruptcy Act § 199, 11 U. S. C. § 599; 6A Collier, Bankruptcy ¶ 9.13 [2]; and the "six-months rule" applied to equity receiverships has no analogue under § 64a. See *Dudley* v. *Mealey*, 147 F. 2d 268 (C. A. 2d Cir. 1945).

[8] *E. g.*, compare Act of July 1, 1898, c. 541, § 64a, 30 Stat. 563, with Act of May 27, 1926, c. 406, § 15 [64a], 44 Stat. 66; compare 80 Stat. 270, 11 U. S. C. §§35, 104 (a)(4) (Supp. II, 1965–1966), with Act of June 22, 1938, c. 575, §§ 17a (1), 64a (4), 52 Stat. 851, 874.

suggested distinction between "debtor" and "estate" would be meaningful only if the two words pointed to different sources of liability. Here, petitioner's negligence claim, if allowed, would diminish the debtor's estate irrespective of whether it were treated as an administrative cost under § 64a or as an ordinary negligence claim under § 63a (7). With respect to the Court's second argument, Chapter XI provides that the straight bankruptcy provisions, including § 63a (7), are applicable to arrangement proceedings only "so far as possible." Bankruptcy Act § 378 (2), 11 U. S. C. § 778 (2). I have no difficulty in concluding that, where the claim does not arise until after the arrangement petition is filed, it is manifestly impossible for a lawsuit on that claim to precede the filing of the petition. Further, I know of no more complete way to "read the time limitation of § 63a (7) out of the Act" than by treating certain negligence claims as administrative costs as the Court does in this case.

I see no basis in equity or in the statutory language or purpose for subjecting every class of creditors except petitioner's to a loss caused by the negligence of a workman. Consequently, I would construe "actual and necessary costs" as limited to those costs actually and necessarily incurred in preserving the debtor's estate and administering it for the benefit of the creditors. I would not include ordinary negligence claims within this class.